

120.0000 COMPUTERS, PROGRAMS, AND DATA PROCESSING

—Regulation 1502

See also Mailing Lists and Services

(a) IN GENERAL

120.0004 Access to Database. Taxpayer is in the business of selling access to a financial information database. The taxpayer provides access to the database by installing a prewritten computer program on its customers' computer, and title and possession of the prewritten computer program remains with the taxpayer at all times. Taxpayer's customers do not have physical possession of the storage media containing the prewritten computer program at any time and the customers do not have control of their computers while the prewritten program is being installed on the customer's computers. If customers should cancel the service, the software program is deleted from their computers. Under these circumstances, tax does not apply to the amount charged by the taxpayer to its customers for the right to access the financial information database. 12/31/96.

120.0005 Accessing of Database. An out-of-state person requested information regarding the application of sales and use tax to the following transactions:

(1) A resident of California uses the computer and calls an on-line data service. The individual searches the database, reviews the results on the screen and takes handwritten notes. Assuming the database provider charges for the search, is any sales or use tax due?

(2) The access and search are identical to (1) except that the results are downloaded into the individual's local terminal and either printed out on the individual's printer or saved to a diskette. Is any sales or use tax due?

In both transactions, the database operator provides electrical signals which contain the information sought by the user. Since no tangible personal property is transferred to the user and the database operator performs no fabrication of tangible personal property supplied by the user, no sales or use tax applies.

(3) The access and search are identical to (1) except that the completed information is printed out by the database operator and mailed to the individual. Is any sales or use tax due? Does it matter if the database provider resides in or out of state?

Where a database operator provides information in response to the unique request for information from the user, the operator is providing a service. Since the operator is regarded as the consumer of that property, neither sales nor use tax applies to the transfer. If the operator consumes the property in California, use tax applies to the operator's use of that property measured by the operator's cost of the property unless the operator has already paid sales tax reimbursement to its vendor when purchasing that property.

(4) Does the taxability of these transactions change if the state resident dials (a) an 800 number, (b) an out-of-state number, or (c) an in-state number?

Since these transactions are not sales, this question is not relevant. However, this factor would not alter whether a transaction is subject to tax or not. 9/21/90.

120.0006 Address Labels. A taxpayer maintains customer address files for clients. When requested by its clients, the taxpayer prints address labels and delivers them to the clients. A flat monthly charge is made for maintaining and updating files and a separate charge is made for each label printed. On occasion, clients request file printouts for which the taxpayer makes a charge. Tax applies only to the charge for the printouts. They are not regarded as mailing lists under Sales and Use Tax Regulation 1504. Under Regulation 1502, charges for file maintenance and printing address labels are not taxable. 6/9/82.

120.0008 Annual On-Line Database Contract with Transfer of Publications. A taxpayer who is an information research firm offers an annual license to an Internet-based financial database. The database resides in a server at the taxpayer's premises, and licensees access it via their web browsers. The annual license fee is \$15,500 and includes two publications. There is no separate charge for the publications included with the license but when they are sold separately, the subscription price of these two (together) is \$2,995 (\$2,495 and \$795 for each publication when sold by itself). Also included with the license is the choice of two off-the-shelf reports which sell separately for \$750.

The annual license fee is both a contract for the providing of a service (i.e., access to the Internet database) and a contract for the sale of tangible personal property (i.e., the publications and the off-the-shelf reports). As such, tax does not apply to the charges solely for access to the Internet database, which equals \$11,755 [\$15,500–\$3,745 (for periodicals and reports)]. Tax applies to the charges for the publications unless the sale qualifies for the periodical exemption. Finally, tax applies to the gross receipts from the sale of the off-the-shelf reports because the reports are neither periodicals nor custom reports. 9/18/97. (M98–3).

120.0009 Bundled Hardware and Software Maintenance Contract (Optional). A contract for optional hardware maintenance is not a contract for the sale of tangible personal property and no sales or use tax applies to the charge. On the other hand, a contract for software maintenance under which the customer will receive updates or error corrections on tangible media is a contract for the sale of tangible personal property. Furthermore, if a software maintenance contract includes a mandatory charge for consultation, that charge is included in the measure of tax from the sale of the software maintenance contract. Therefore, when a bundled contract includes a software maintenance portion and a hardware maintenance portion, the charge for the hardware portion of the contract is nontaxable. The contract should be prorated between the taxable software maintenance portion and the nontaxable hardware maintenance portion of the contract. 7/15/96. (Am. 2004–2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0013 Charges Associated with Computer Software. Information was requested regarding the application of sales tax to the following:

(1) Consultations with clients and training seminars held on site at offices. The charge for merely consulting or providing seminars, without the transfer of

tangible personal property in connection with consultation or training is nontaxable.

(2) A monthly charge billed to the clients for telephone support and periodic updates of software. The charge for a software maintenance contract, which provides updates and future releases, is a contract for the sale of tangible personal property and is taxable. If maintenance cannot be acquired by the client without telephone support, the telephone support (consultation) is part of the gross receipts and is subject to tax. (See Regulation 1502.)

(3) Special programming that is done in office and sent to clients via the phone lines using a modem.

If information is provided to a client by remote telephone modem, the charge is nontaxable. 3/12/92. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0014 Charges for Code to Access Information on CD. A taxpayer creates a database of technical information on CD. The CD is then marketed through distributors and directly to consumers. The CD contains information covering several different applications. Usually, limited access to the data on the CD is sold to consumers by the distributors, but the consumer must contact the taxpayer to obtain a code to access that information. When the consumer contacts the taxpayer to obtain the access code, the consumer is told of additional information on the CD that is available for an additional charge. If the customer agrees to pay this fee, the taxpayer provides no tangible personal property, but rather provides only access codes that will unlock the additional information on the CD that would otherwise be inaccessible to the customer.

The taxpayer owes sales tax on its charge to the consumer for access to the additional information on the CD whether the charge is made to a customer who purchased the CD directly from the taxpayer or to a customer who purchased the CD from a distributor. 9/5/96.

120.0015 Charges Related to Both Installation and Hardware. The taxpayer sells computer hardware and software, and charges for related services such as hotline support, miscellaneous supplies, repair parts, employee travel expenses for site preparation and installation of hardware and software. Sales tax applies to the retail sales of hardware, miscellaneous supplies, repair parts, and pre-written and sub-licensed software.

Sales tax also applies if the client is required to purchase a maintenance contract or the hotline support service. Separately stated travel and subsistence expenses should be allocated between the taxable charges for site preparation and the exempt charges for installation of hardware and software. Charges for testing a pre-written program on the client's computer is part of the installation of the program and are exempt. 6/9/89.

120.0015.800 Lease of Software. Software is transferred by telecommunication from disk media owned by the transferor to tape media owned by the transferee, with

the transferor retaining ownership and possession of the disk except that by contractual agreement the disk was placed in escrow for five years. The transferee is allowed access to the disk upon request for the purpose of verifying the accuracy of the software. Also, by the same agreement, the transferor agrees to not remove the disk from escrow, use or make copies of the disk, or permit any other person to have access to the disk.

The agreement has the characteristics of a lease because the transferee has effective possession, use, and control of the disk during the five year period. The transferee is liable for use tax on the payment for the transfer and the tax must be collected by the transferor and remitted to the Board. 8/1/86.

120.0018 Charges for Updating Mailing. Company A is a provider of automatic data processing services and maintains mailing lists for clients on its automatic data processing equipment. When Company A maintains a mailing list for a client and prepares through its automatic data processing equipment a single galley-bookrun of names and addresses to be updated by the client and returned to Company A for use in updating its mailing list for that client, Company A's separately stated charges to the client for that galley-bookrun are not subject to sales or use tax. 1/18/77.

120.0023 Computer Assisted Design (CAD) Services. A customer supplies drawings, blueprints, sketches, and written descriptions and, in return, receives a disk produced by the use of CAD software. The information on that disk is expressed mathematically rather than graphically. This constitutes the type of nontaxable service described in Regulation 1502(d)(5)(A) because the person furnishing the disk was required to manually edit, check, and/or otherwise prepare composite drawings, detail drawing, or layered drawings from the information supplied by the customer. The results are fundamentally different from copying, optical scanning, or blueprinting manual. Since the customer receives the information in the form of mathematical data, the customer can manipulate that data through the use of its own computer programs. The service remains nontaxable even if a pen plotted drawing was supplied together with the CAD data on the disk. 12/20/88.

120.0030 Computer Data Bases. A client contacts the taxpayer with the medical name of the client's ailment. The client commonly questions a diagnosis their doctor has given. The taxpayer researches the most current medical information on the ailment in a computer data base and sends the client a computer printout discussing the ailment. The charge for such research and computer printout is for a nontaxable service. The true object of the transaction is medical diagnosis. The computer printout is the means to transmit the product of the service and is only incidental to providing the service of medical research and diagnosis. The charges for such a service are not subject to tax. 7/26/88.

120.0040 Computer Forms Printer. Where an automatic data processing service bureau reproduces a customer's output on a Computer Forms Printer, the reproduction charges are subject to sales tax because the data are not transferred by computer program and no new information is developed. If the data is transferred by computer program and new information is developed, the processing is not taxable because the object of the contract is service. The nontaxability of the basic

processing of the data will not be affected by the use of the Computer Forms Printer to reproduce extra copies. If the computer firm cannot identify the separately taxable portion of the charges for the processing contract, all charges are taxable. 2/5/70.

120.0042 Computer-generated Output (CAD). Taxpayer does computer aided drafting (CAD) “services” by redrawing of paper drafting documents such as architectural blueprints or electrical schematics which become digital computer files of information. Taxpayer recreates the drawing so as to duplicate its every dimension and text or data unit. In recreating the drawing certain processes are automatically performed while other activities are done manually by the operator. The original drawing document and the electronic file are then returned to the customer with the electronic file stored on a floppy disc.

Computer-generated output of redrawn architectural blueprints is subject to tax. (Sales and Use Tax Regulation 1502(c)(4).) 12/13/91.

120.0048 Computer Program Training Materials. A taxpayer develops a training course for a software manufacturer for a program not yet on the market. The course materials include a disk containing an instructor’s guide, a participant workbook disk, a disk containing overheads, and a disk containing sample files. The taxpayer transfers all of its reproduction rights to the course materials to the software manufacturer. The software manufacturer edits the materials and markets the training course under its own name. The sale of the disks containing word processed disk copy is not subject to tax as it is similar to an author’s original manuscript containing the expression of an idea. The sale of the graphic material, whether on disk or on hard copy, is comparable to the sale of artwork for reproduction or display and is, therefore, taxable. 6/14/90.

120.0050 Computer Services. A person operates an on-line service for the buying and selling of consulting services, software and information. The “service” links information sellers with the information buyers through the seller’s and buyer’s personal computers and a host computer system maintained in California. The “service’s” contact with this state consists primarily of mailings, advertisements in magazines and telephone connections. Periodic appearances may be made at conventions, trade shows and user’s group meetings where free access and demonstration software may be given away.

Both buyers and sellers access the system using their own computers and a modem. Information is delivered electronically over the telephone line without the transfer of tangible personal property. The “service” provides a forum for the buyer and seller to meet. The “service” derives its revenue by charging transaction fees, connection charges, one-time new account sign-up fees, monthly service fees and storage fees. The “service” also is involved in collecting from the buyer and paying the seller.

The activities of the “service” qualify the “service” as a retailer, by maintaining the host computer in California, the “service” occupies a “place of business in this state,” section 6203.

The “seller’s” charges for (1) consulting services sent electronically through the computer, (2) prewritten text sold electronically through the computer, and (3) other information, such as computer software graphics, sound and template, are not subject to tax provided that no tangible personal property is sent to the buyer. In addition, tax does not apply to the transfer of information by electronic telecommunications from a remote location, if there is no tangible personal property sent to the buyer. If the person described as the “seller” sends a hard copy of information to the buyer, the entire charge would be subject to sales or use tax.

Depending on the facts of the transaction, the person operating the service may well be the retailer responsible for payment of any sales tax or collection of any use tax on the transaction. 12/9/92.

120.0052 Computer Software—License to Use and Sell. A corporation enters into a contract for the sale of software which provides for a \$300,000.00 payment plus a license fee for the right to incorporate the software into custom software to be developed and sold by the purchaser. The contract also allows the purchaser to use the program for “purposes of processing customer data and for marketing.”

The amount of the license fees attributable to the “right to incorporate” and resell the software, is excludable from the measure of tax pursuant to Regulation 1502 (f)(1)(B). The portion of the \$300,000 fee which is attributable to the customer’s right to use the software is subject to tax, unless the software sold by the corporation is a “custom computer program.” 6/12/91.

120.0053 Computer Software Programs. A company develops applications and systems software programs. The software, which is sold to original equipment manufacturers, (OEM) consists of two components: a “kernel” which is identical for all users regardless of the hardware, and a device-implementation portion that is unique for each type of hardware upon which the program will operate. The company licenses this software to OEM’s under license agreements allowing sale of the software along with the hardware the OEM’s sell to their customers. The company usually develops the entire kernel. The device— implementation is developed either entirely by the company, entirely by the OEM’s, or jointly. Both the kernel and the device implementation, if any provided by the company may be in source program and/or object program format. The charge for this company’s software is not separately stated in the charge made by the OEM’s to their customers. The OEM’s pay the company the following fees:

- (1) royalties related to the hardware items containing the software sold or distributed by the OEM’s;
- (2) a non-recurring engineering fee for services in developing a device— implementation;
- (3) a source license fee when the company provides some or all of its software in source;
- (4) a fee for distribution to end users of documentation provided by the company in excess of a certain number of free copies.

Regardless of the manner or formula for determining the royalty payments and license fees and regardless of whether the copyright program is transferred by way of a source program and/or an object program format, no sales or use tax applies. This is also true regardless of whether it is delivered in the form of systems software or hard-wired board which would be inserted into the OEM's hardware. Neither sales nor use tax applies to non-recurring engineering fees with respect to services rendered by the company to develop software which is not part of a sale of tangible personal property. In addition, neither sales nor use tax applies to fees for software updates provided by the company to an OEM under a license agreement when a copyright attaches to those updates and they are transferred solely for the OEM to sell copies of those updates. 9/21/90; 1/17/91.

120.0054 Computer Terminal with Analysis of Electrocardiograms. A lessor rents computer terminals to physicians for use in their offices. The equipment is used to provide analysis of electrocardiograms (ECGs) performed in the physician's office. The terminal is described as a three channel, ten wire, twelve lead ECG instrument which connects directly to the patient to take readings on the twelve leads automatically. The patient's age, weight, and other data are entered via a keyboard and included on the printed report. The terminal is connected via telephone lines to the lessor's central computer. The terminal automatically dials the computer and transmits the collected ECG data. In seconds, the computer responds and the terminal prints a complete analysis of the ECG. In addition, a board-certified cardiologist is on call at the computer site to review and assist in interpreting the report. A physician can call the computer site and discuss the report with the specialist. The lessor charges a flat amount per month for the equipment. In addition, a separate charge is made for each time that the equipment is used to provide an ECG analysis. No charge is made for telephone consultations with the cardiologist.

The separately stated amounts charged for ECG analysis are service fees and, therefore, not subject to tax. Monthly charges for the equipment are lease receipts subject to tax unless leased in substantially the same form as acquired and tax has been paid at the time of acquisition. 1/17/83.

120.0055 Computer Tutorials or Promotional Programs. A taxpayer prepares educational or promotional tutorials on electronic media for operation on a computer. No other tangible personal property is transferred. The taxpayer contracts for the "graphic art" to be included in the tutorial. The "graphic art" may include the production of preliminary art, finished art, consultation and research, supervision, motion picture production, photography and videotaping.

The charges to the taxpayer for the graphic art are subject to tax. The graphic artist may avail itself to the exclusion for preliminary art provided the criteria in Regulation 1540 are followed.

A motion picture is not "graphic art" as contemplated by Regulation 1540. A transfer of a "qualified motion picture" to the person for use in producing a computer program, is not subject to tax; rather the person producing the "qualified motion picture" is the consumer. 1/27/92.

120.0060 **Computer Work.** If the product of a computer operation consists simply of punchcards or other tangible property prepared from data supplied by the customer, the operation constitutes a processing of personal property and is taxable as a sale under section 6006(b). However, if the operation involves the development of information or evaluation of data so that the operator of the computers is actually creating ideas, information or concepts, then he would be performing a service and would be considered the consumer rather than the retailer of cards or other tangible property delivered to customers. 9/28/66.

120.0100 **Computer Work.** When a computer center enters a contract which provides that the center will keypunch data from source documents received from a client, verify the data, correct it, feed the material into a computer, and produce reports therefrom, the charges are not subject to tax because the contract is a service contract. However, where a computer service center enters into a contract solely to keypunch or keypunch and verify the data, the charges are taxable since they constitute charges for fabrication and the sale of tangible personal property. Similarly, charges for solely reproducing punched cards, print outs in the form of printed labels or multiple copies of reports are taxable. 3/20/68.

120.0100.500 **Consulting Services.** A taxpayer is engaged in the business of providing consulting services in connection with computers and computer applications. These services include after the sale consulting with the purchasers of the equipment and are related to business needs and applications of the purchased computers and software, training the client's staff, troubleshooting the equipment and system for the first 90 days. The agreement for the initial 90-day period also involves bringing the client's business entity on-line into a fully computerized working system. The taxpayer states that it did not, and would not, provide hardware and software to any client to whom it extends a proposal unless the client also agreed to that portion of the proposal requiring the client to enter into a simultaneous support agreement. Two separate written agreements are issued (1) for the sale of computer software and hardware, and (2) for consulting, maintenance, training and installation services. The company believes that bifurcation of the client's acceptance of a unitary bid into two separate written agreements avoids inclusion of gross receipts under the support services agreement in the measure of tax even when both agreements are included on the same invoice.

A contract must be viewed in its entirety including the offer, any acceptance(s), and consideration passing between the parties. The Agreement for Purchase of Equipment and the Agreement for Purchase of Support Services memorialize mutually contingent contractual terms that are the subject of one proposal. The taxpayer's admission that it would never provide hardware and software unless its client also agreed to accept the support services offered in the bid demonstrates that the bid is a nonseverable offer which is capable of acceptance only by agreeing to all terms. The taxpayer's statement that the offer or proposal was not severable made acceptance of the resulting contract all-or-nothing. Whether reduced to one writing or two, the company offered a nonseverable contract to provide services in connection with the sale of tangible personal property. Therefore, only that portion of the support services contract attributable to

installation labor in connection with the sale of tangible personal property is excludable from gross receipts. 2/28/90.

120.0101 Copyright Royalties. Tax does not apply to a transfer of a copyrighted program to a customer for the purpose of transferring the federal copyright interest, where the customer's payment of license fees or royalties is for the right to reproduce and distribute the program for a consideration to third parties. However, site license fees and other end user fees paid by the customer remain taxable. (Regulation 1502 (f)(1)(B).) 8/23/88.

120.0101.250 Copyrights and Prewritten Programs. Corporation "A" sold an entire division to Corporation "B." Included in the sale were two canned software programs. Corporation "B" obtained title along with the copyright interest in the programs. Also, as a part of the agreement, Corporation "B" granted back to Corporation "A" a license to copy and sublicense one of the programs for use only in the mechanical segment of the printed circuit board market. In addition, Corporation "B" licensed back to Corporation "A" a right to use the same program for Corporation "A's" internal use only.

Under Regulation 1502(f)(1)(B), the transfer of the copyright interests in these programs in the Asset Purchase Agreement is nontaxable. Corporation "A" transferred the copyright interest in these programs to Corporation "B" so that Corporation "B" could publish and distribute copies of the programs for consideration to third parties, and the transfer of the copyright is not limited to copying the programs for Corporation "B's" own internal use. In this situation, the amounts Corporation "B" paid for these copyrighted programs were not for site licensing or other end user fee amounts, which would have been includable in the measure of tax under Regulation 1502(f)(1)(B).

With respect to Corporation "A" acquiring from Corporation "B" a license to use the source code for one of the programs for internal use, this is also nontaxable because there was no transfer of tangible personal property from Corporation "B" to Corporation "A." Instead, Corporation "A" merely retained certain rights to the program when it transferred the program to Corporation "B." 4/22/88. (Am. 2002-3).

120.0101.500 Database Access. A taxpayer gathers data from the hospital industry, that is, room usage, rates, etc. The taxpayer sorts, compiles, and stores the information on its computer. Computer printouts are prepared in graph form showing trends of a particular hospital or hospitals. The graphs are then provided to subscribers. A subscriber might want information regarding only itself, or it might want information on all the hospitals in the area. The furnishing of graphs is regarded as a sale of tangible personal property, not as the providing of a service. The graphs do not constitute exempt periodicals because they do not include any text. 8/25/82.

120.0101.800 Data Information Services—Internet. A company provides weather data to its customers. The customers access the information by logging onto the company's service through the Internet. The company does not transfer any tangible personal property to its customers. No sales tax applies to its charges. 7/10/96.

120.0102 Data Processing and Data Entry. A taxpayer requested information regarding the application of tax to the following cases:

(1) Keying of customer's paper documents and providing magnetic media (diskette or computer tape). Custom program services are necessary to allow the data entry to commence.

Charges for data entry are taxable whether the storage media are furnished by the customer or by the data processing firm. When programming is performed for use in performing taxable data entry, the charge for programming is taxable. The programming service is an expense in fabricating the magnetic media desired. Section 6012 prohibits the deduction of these "service costs."

(2) Same as (1) except the data is transmitted over telephone lines, using a "modem."

Provided that tangible personal property is not transferred, tax does not apply to the charge if the transfer of information is by remote telecommunication from the data processing firm to or through the purchaser's computer.

(3) Same as (1) except that instead of magnetic media, an address list only is provided. If a mailing list is created from documents provided by a customer by using a typewriter or word processor, tax does not apply to the charge for the original document and carbon copies produced simultaneously with the original. Tax does apply to charges for producing multiple copies of the document.

(4) Same as (3) but in addition to the address list, magnetic media is also provided. Since magnetic media is transferred to the customer, the entire charge is taxable regardless that an address list is also provided to the customer. 4/15/92.

(Effective 1/1/94, due to a statutory change, "mailing lists" also includes a magnetic tape or similar device used to produce written or printed names and addresses by electronic or mechanical means. Therefore, magnetic tape mailing lists are exempt where a contract restricts the purchaser to a single use of the mailing list.)

120.0103 Data Processing Services. A company is engaged in selling turnkey computer packages with the use of the software programs being licensed to the user with no privileges of reselling the software program. Sales tax is charged on the entire package including both hardware and software and on charges for any subsequent modifications or enhancements made to the software program after the initial installation. It was asked whether sales tax applies to the following transactions:

(1) (a) Repair to software programs which have become garbled or damaged due to environmental conditions. The repair only restores the program to its original condition and does not improve or modify it.

(b) Similar repairs to data files.

Assuming the "repair" is accomplished by furnishing the customer a new disk or tape on which is recorded the "repaired" program or data file, for which a charge is made, both types of transactions are subject to tax. The tax applies for the same reason that it would apply to the sale of a duplicate disk or tape on which has been

recorded a program or data file. It is simply the transfer for a consideration of tangible personal property and constitutes a taxable sale.

(2) The enlargement of a data file due to a customer's growth where there is no change in, or addition to, existing programs.

Assuming that "enlargement" means that for a fee the customer is provided a new disk or tape with the enlarged data file recorded on it, the transaction is subject to sales tax for the same reasons set forth in 1 above. 5/18/81.

120.0104 Database. A firm is engaged in the business of providing a computer database service. The firm contracts with a vendor who has a mainframe computer to store its database in the computer. The firm delivers software to its customers that enables the customer to connect to the database. The customer is charged based on time usage, access fees, and database utilized.

Assuming that title to the software is transferred to the customer or it was developed in-house and licensed for use, the transfer of the software is subject to tax as a "sale." The firm must make a fair and reasonable allocation of its charges between the charge for database access and the software. 1/24/90.

120.0105 Design of Circuit Board. A designer of printed circuit boards uses computer and computer aided design ("CAD") software to design the layout of electronic components on a printed circuit board ("PCB") from drawings provided by its customers. Information from the drawings and other reference materials is entered on the type, size and electronic characteristics of the circuit components onto the CAD software data base.

The software program is used to manipulate the data to generate the optimum design for the PCB. When completed, the design information is transferred to the customer:

(1) via a computer modem over telephone lines or in the form of computer data on a tape cartridge or floppy disk, and

(2) in the form of fabrication and assembly drawings on vellum.

The designer issues an invoice for the design and a separate charge for photoplots. No separate charge is made for tape cartridges, floppy disks or vellum. Given this information, tax does not apply to:

(1) charges for tangible representations of the design except where the drawings are suitable for use as camera-ready art, and

(2) the transfer of information by modem as this is not the transfer of tangible personal property.

However, tax does apply to:

(1) the sale of manufacturing aids used in the production of the PCB such as photoplots, and

(2) the sale of photoplots whether the designer develops the design or the customer develops the design even if the customer were to provide the material the designer uses to create the photoplots. 8/30/93.

120.0106 Dial-Up Access to Computer Database. A company offers subscriptions to a dial-up computer database service. Subscribers gain access by using personal computers and modems. As such, they have on-screen access to the statistical information contained in the database, and can issue commands to retrieve and manipulate data in order to make reports. The subscribers can then either view reports on-screen or download the reports to their PC's storage and printing.

Provided all of the reports received by the subscribers are sent over the telephone lines and any hard copies generated are printed by the subscribers themselves, the company's charge for the subscriptions is not subject to tax. Electronic transmissions of information that do not involve the transfer of tangible personal property are not taxable. 7/17/92.

120.0107 Driver Source Code. Company A is planning to contract the development of a software product from Company B. Company B will purchase an unlimited source code for Company A from the manufacturer, modify the driver source code, and deliver the original and modified source to Company A at project completion.

It appears that Company B merely acts as an agent on behalf of Company A in acquiring the program from the manufacturer. If this is true, the relevant transaction is the transfer of the program from the manufacturer to Company A. Tax does not apply to the amount paid for the license or royalties by Company A to the manufacturer for the transfer of the program to Company A if the transfer is to provide Company A with the right to reproduce and copy a program to which a federal copyright attaches in order for Company A to publish and distribute the program regardless that Company A has Company B modify the program to be compatible with Company A's application. 8/31/92.

120.0107.800 Electronically Delivered Graphics. A publishing company located in California provides a monthly sample of new clip art to its customers on the Internet for a \$50 a month fee. Customers may also (1) subscribe to a monthly clip art diskette which is mailed directly to the customer's place of business or (2) subscribe to an electronic clip art newsletter which is available on the Internet and sent to the customer via e-mail.

Sales tax applies to the sale of graphics in the form of tangible personal property. Therefore, the sale of the artwork on the diskette is subject to sales tax since it is tangible personal property. Sales or use tax does not apply to the transfer of graphics by electronic transmissions. For example, the art work is sent to the customer by modem or posted on an electronic bulletin board and the recipient does not receive any tangible personal property, the transaction is not a sale subject to tax. A charge solely for on-line access is not taxable because such on-line access does not involve the transfer of tangible personal property. 3/29/96.

120.0108.180 Evidence Artwork was Transferred by Modem. The transfer of artwork by remote telecommunications, such as modems, is not a sale of tangible personal property. Thus, tax does not apply to charges for artwork that is transferred by modem. The advertising agency must retain some form of evidence to support the claim of transmittal by modem. Such evidence could include the acknowledgment of receipt indicating the recipient's receipt of the artwork by modem. It is also

suggested that the seller, advertising agency, state on the invoice that delivery was by modem and retain a hard copy of the artwork with a dated notation of the electronic delivery. 1/28/97.

120.0108.225 Extracting Information from Customer's Documents. A taxpayer contracts to extract information from documents provided by its customer and to perform data entry. Then, the taxpayer returns this information back to the customer in electronic form via electronic transmission to the customer's computer.

Data entry is regarded as taxable fabrication under Regulation 1502(d)(2) if such data entry is transferred to the customer in tangible form such as on storage media or if the taxpayer performs the data entry on the customer's computer. However, if the information is transferred by remote telecommunication and the customer does not obtain any tangible personal property such as tapes, disks, or other storage media, the transfer does not constitute a sale of tangible personal property. (Regulation 1502(f)(1)(D).) 8/31/95.

120.0108.350 Free Program Updates. A taxpayer purchases a prewritten computer program. Royalties are paid to the vendor depending upon the amount of use of the program. The program is updated periodically at no additional cost. The updates are made over telephone lines. The providing of updates by telephone lines is regarded as a service related to the sale of the original program. Tax applies to the entire royalty charge. 6/5/81.

120.0108.390 Furnishing Database Information. A taxpayer compiles its own, nonexhaustive database containing information on the shipment of prescription drugs. Taxpayer's clients request specialized reports regarding the sale of a particular pharmaceutical in relationship to a particular category of pharmaceuticals. The taxpayer compiles these reports by developing information through statistical analysis of the information in its database. That is, the taxpayer does not merely provide its clients with portions of its database to fulfill their requests, but rather creates customized information through a significant and substantial analysis and selection process.

Under these facts, the taxpayer is regarded as providing tangible personal property incidental to the providing of a service when it provides a single computer tape to its customer in response to a specific inquiry by that customer. Tax would apply, however, to additional copies provided to a customer, or in any situation where the taxpayer provides a significantly similar copy of information to a customer that was previously provided to another customer. 9/16/97. (M98-3).

120.0108.400 Furnishing of Data to Customers and Processing Customer Data. A firm supplies a weekly listing of economic indicators and a graphic representation of these indicators to its customers. The firm also receives data from its customers which it uses to generate graphs by computer. In some cases, arithmetic calculations such as averages and trends are made. The sale of the weekly listings of economic indicators is taxable unless the reports qualify for exemption as periodicals. The conversion of customer-furnished data to graphic form is taxable unless arithmetic calculations are made. 9/28/79.

120.0108.500 Graphics on Computers. A graphic artist, an independent contractor, contracts with clients to create and transfer artwork in the following ways:

(1) The graphic artist uses the client's computer to create artwork which is saved on the client's hard disk.

(2) The graphic artist creates the artwork on its own computer and saves the data on a floppy disk. This diskette is then taken to the client's place of business, inserted into the client's computer, and saved on the hard disk. Some additional work may or may not be accomplished.

(a) The diskette is retained by the graphic artist.

(b) The graphic artist leaves the diskette, with the client for backup purposes.

(3) The graphic artist creates the artwork on its own computer and saves the data on a hard disk. This hard disk is then taken to the clients' location and connected to their computer by means of a cable. The data is then transferred to the clients' hard drive.

With the exception of situation (2)(b), sales tax does not apply to the graphic artist's charges in the other situations. In situation (2)(b), the graphic artist's transferring a diskette to the client results in the graphic artist making a retail sale of tangible personal property.

When a person performs labor which is merely the operation of clients' computer system, the labor is not fabrication labor whether the clients' computer is new or used. Saving work to the permanent internal storage (hard drive) of the computer is not fabrication of the computer.

On the other hand, tax applies to charges for artwork when the artist saves the work to a medium which is typically separate from the permanent internal storage of the computer. For example, if the artist were to create the artwork and save it to a disk or print a hard copy, the transfer to the customer of that medium would be a sale of tangible personal property. The artist's transfer of artwork on a new "customer furnished" diskette would be a taxable sale. (Regulation 1502(c)(2) and (c)(4).) 03/05/96.

120.0109 Hourly Charge for Creating Illustrations. An independent contractor bills his time by the hour, creates designs and illustrations through a computer program, and then prepares a computer presentation file. The client has the option of showing the file on a computer, converting it into 35mm slides, or printing it on paper. Even though the contractor charges by the hour, the charge for creating designs and illustrations is subject to sales tax. Accordingly the charge for the computer presentation file is subject to tax. 10/14/93.

120.0110 Improvements to Leased Programs. Taxpayer leased a canned program to its customer. For a set monthly fee, taxpayer also notified the customer of any recently developed improvements to the program. If the customer desired to incorporate the improvements into the program, upon payment of an additional charge, taxpayer recorded the entire improved program on magnetic tape supplied by the customer and transferred the tape to the customer.

The recording of the improved program is a taxable fabrication under Regulation 1502(c)(2). The monthly fee to receive notice of the improvements is included in the measure of tax, since payment of the fee is a prerequisite to purchasing the improvements. 11/5/79.

120.0114 Installation of Computer System. A company contracts with a customer for the installation of a computer system and an information management system. Specific tasks are:

- (1) Installation of some hardware and printers. Tax does not apply for installing the hardware.
- (2) Convert the customer's existing files to the new format. The charge for converting the existing files to the new format is subject to tax.
- (3) Install and test the leased software on the customer's computer and install the customer's converted data files onto the customer's computer. The charge for these installation functions is not subject to tax.
- (4) Train the customer's staff on using the leased software, etc. Generally, if the charge for training service is optional, the charge is not subject to tax.
- (5) Fee covering the cost of the company's staff to travel to the customer's site to perform some of the above functions.

Depending on the taxability of the underlying charge, the charge for travel is taxable or nontaxable. The charge for travel related to nontaxable installation of hardware is nontaxable. The charge for travel related to the reformatting of data is taxable. 8/6/92.

120.0115 Installation of Software. Charges attributable to the actual installation and testing of software to ensure that the program operates as required are not taxable. Charges attributable to converting the customer's data to a different format are taxable. 2/14/95.

120.0115.300 Internet Access. A company provides Internet access without providing any tangible personal property to its customers. It is not selling or leasing tangible personal property by providing Internet access, and its charges for that access are not subject to tax. 2/23/98. (M99-2).

120.0115.325 Internet—Access to Database. A firm collects résumés at job fairs and a variety of other sources. It creates a database of these résumés and sells access to its customers in order for them to conduct searches for potential employees. The firm charges an access fee for the database search and a subscription fee based on the quantity of résumés viewed. The firm does not sell or lease any tangible personal property to its customers in the course of providing this service. Customers use their own computers and the Internet to access the database which is maintained on computers solely within the possession and control of the firm. The firm does not provide any software to the customer.

Under these facts, tax does not apply to the firm's subscription charge or access fee to its customers for viewing its résumés database since it is not selling or leasing any tangible personal property. 4/19/96.

120.0115.700 Lease of Database. A database system includes application software which has been licensed to the provider of the database. The database provider delivers a diskette to its customer. It cannot sell the system because it does not own the system. The subscriber manipulates the data to obtain information which he desires. The subscriber receives weekly updates of the data base.

The provider of the database is the retailer of the database system if the subscriber is not required to return the diskette. If the subscriber is required to return the diskette, the transaction is a lease. Since the property is not leased in substantially the same form as acquired, the lease receipts are subject to tax. 6/7/91.

120.0115.800 Library Catalog Information Transmitted via the Internet. A library contracts for the purchase of books and the transmission of cataloging records via the Internet with each charge stated separately. The sale of the books to the library is taxable as a sale of tangible personal property. However, the charges for the cataloging of records transmitted solely through the Internet is not taxable so long as no tangible personal property, such as a courtesy "hard copy," is received as part of the transaction. 11/24/97. (M99-2).

120.0115.900 License for Copying Customized Basic Operating System Programs.

The taxability of license fees and royalty payments for reproduction or copying customized basic operating system programs is set out in Regulation 1502(f)(1)(B). Tax does not apply to the license fees and royalty payments if the customers are not the end users of the operating system programs, but reproduce these programs for sale or license to their customers. If the customers were the end users, tax would apply to these charges for the use of the program. 1/14/88.

120.0116 License and Royalty Fees. If a transaction involves the transfer of software but the purpose of the transfer is to grant the transferee the right to copy and sell software under circumstances that such copying and selling would otherwise be a violation of the transferor's federally protected copyright interests, the transfer is not subject to tax. Tax does not apply whether the transferee sells the program in the form in which it is received, modifies it and sells the modified program, or incorporates it into another program and sells that program. 11/17/94.

120.0117 License/Sublicense of Canned Software. A customer of a software retailer has requested the retailer to obtain a license for canned software and, in turn, sublicense the software to it in substantially the same form as acquired by the retailer. The distributor of the software is aware of the sublicensing by the retailer. This license and sublicense is a nonexclusive, nonassignable, and nontransferable license to use the program. The program can only be used on one computer where the program is installed.

The license term is characterized as a lease for an initial period of 12 months. The licensee (and sublicensee) have the right to extend the term for two additional 12-month periods unless either the licensee or distributor gives notice to the other party of the intent to terminate or renegotiate the agreement at least 60 days prior to the anniversary date. If within this 3 year period, the license is terminated for any reason, the licensee is to de-install the program from the computer on which it is installed and either certify to the lessor that the program was destroyed or return the program to the distributor.

The license fee is \$27,000 and is due upon installation of the program. The annual renewal fee (referred to as a maintenance fee) is \$6,000 and is due for each of the 2 years commencing on the first anniversary date. If after the three year period mentioned above, the licensee fails to continue its “lease” payments (maintenance fees), the program upgrade and support is terminated and the distributor has no obligation to reinstate. Licensee is not required to return or destroy the program after this three year period.

The retailer pays its vendor \$27,000 upon installation and \$6,000 on anniversary date and the lessor charges its customer \$32,000 upon installation and \$7,000 on the anniversary date.

In this case, there is an outright sale to the retailer followed by an outright sale by the retailer to its customer. During the initial three year period, if the license is not renewed, the retailer has the option of either certifying that the program was destroyed or of returning it to the distributor. After three years, the retailer apparently keeps the program even if the license is terminated. The retailer thus obtains possession of the program with no requirement to return it. This is a sale not a lease. (Regulation 1502(f)(1)(A) and (B).) The retailer’s customer obtains the software on the same basis. Thus, the retailer is making an outright sale to its customer. The sale to the retailer is a sale for resale and is excluded from sales tax. The retailer’s sale to its customer is the taxable retail sale. The measure of tax from that sale is the \$32,000 sales price. Also, the \$7,000 is subject to sales tax since “maintenance” contracts providing for supplying updates and later releases of the software are considered sales of tangible personal property. (Regulation 1502(f)(1)(C) and Annotation 120.0550.) 6/22/95.

120.0118 Microfiche and Digital Scanning. Microfiche filming and digital scanning of customer furnished documents which results in the transfer of film, tape, disks, etc., is taxable. These activities are merely the conversion of customer-furnished data from one physical form to another. 8/12/94.

120.0120 Microfilm. Charges for placing exposed, developed microfilm on keypunched, aperture IBM cards, both the film and the cards having been supplied by the consumer, are taxable receipts from sales. The labor involves the creation for the first time of the desired article, i.e., the card with the film mounted thereon, and is not repair or reconditioning labor. 10/9/62.

120.0125 Modification of Customer’s Electronic File. The company’s customer decided that electronic files, that had originally been created by the company, required certain changes (additions and deletions). The labor of modifying the data was manually completed using keystrokes and the files were returned to the customer on the same medium. The customer was billed an additional charge for the modification. The charge is subject to tax. Charges for modifying or treating consumer-furnished tangible personal property (cards, tapes, discs, etc.) are generally subject to tax. 3/23/92.

120.0135 Multiple Location Access to Data Base. A taxpayer provides a database of drug information to its customers. The customers have multiple locations throughout the country. The taxpayer extracts from its comprehensive database a limited database tailored to the requirements of the individual customer. Each

month, each customer receives an update for its database. The update is transmitted electronically and only to the customer's headquarters location. The customer then electronically transmits the update to each of its other locations. The customer is charged a set fee per location. Tax does not apply as long as all information is transmitted by the taxpayer electronically and no tangible personal property is transferred.

If the database information was sent in tangible form to this state, tax would apply. 6/29/94.

120.0275 Off-Line Printouts. A taxpayer maintains a number of data bases which are available for access by customers. Customers can obtain information electronically and can print the information on their own printers. The taxpayer's charges to customers are based in part on network time. To save network time charges, a customer may instruct the taxpayer's terminal to print information on the taxpayer's printer. The taxpayer then sends the printout to the customer. The taxpayer makes a single charge based on unit price which includes computer time and royalties. Tax applies to the total charge for material printed on the taxpayer's printer. 9/27/79.

120.0290 On-Line Entertainment Service. A taxpayer operates an on-line interactive entertainment service which enables subscribers at different geographic locations to use personal computers to communicate with each other. Each subscriber uses a personal computer, a modem and taxpayer supplies software to operate the service. Subscribers pay a subscription fee. Upon payment of a shipping and handling charge, new subscribers receive on floppy disks a software which enables them to access the taxpayer's entertainment services. There is no separate charge for the software. The software is upgraded periodically and subscribers are sent software enhancements on disks at no extra charge.

Tax does not apply to the subscription charge. If the "handling" portion of the "shipping and handling" fee represents 50 percent or more of the taxpayer's purchase price of the software, the transaction is a retail sale of the software subject to sales tax. (Regulation 1670.) If it is less than 50 percent, the taxpayer is regarded as the consumer of the software. (Regulation 1670.) 7/11/94.

120.0309 On-Line Service. University libraries subscribe to several on-line services which provide information used by students and faculty to support instructional programs and research. Information obtained from these types of services may be viewed on screen by library patrons, downloaded to floppy disks, or printed out locally at the discretion of the patron.

Since the information sought by the patron is transferred by remote telecommunication from the seller's place of business to the Universities, no tangible personal property is transferred. Therefore, sales or use tax does not apply to charges for such services. 10/23/95.

120.0310 On-Line Service and Sale of CD-ROMs. A company is contemplating the transfer of CD-ROMs to its customers in connection with an on-line electronic data service provided over the Internet. Under plan 1, the company will charge the customer for both the CD and the monthly connection over the Internet. Under

plan 2, the company will give away the CDs free of charge and only charge for the monthly connection on the Internet.

Under plan 1, the transfer of the CD-ROM constitutes a sale of tangible personal property. Therefore, the amount of the total charge attributable to the sale of the CD-ROM is subject to sales tax.

Under plan 2, the transfer does not constitute a sale of tangible personal property assuming there is no obligation on the part of the customer to purchase any tangible personal property or any service from the company. Under these circumstances, the transfer of the CD-ROM is not subject to sales tax. However, the company is the consumer of the CD-ROM and the sale of the CD-ROM to the company is the taxable retail transaction. 1/17/96.

120.0350 Optional Maintenance Contract—Equipment and Software. A taxpayer is a manufacturer of industrial equipment used in the production of tangible personal property. One of the component parts of the equipment is a computer that provides necessary automation for the equipment. The computer is integrated into the overall system and is not used for any other purpose. The software controls the computer that in turn controls the equipment. The software was developed specifically for use with the system (equipment) and is not useful on any other equipment. The computer and related software are not major components of the equipment and account for less than 10% of the equipment's cost.

After the expiration of the standard equipment warranty provided to customers at the time of purchase, customers have the option to enter into a lump-sum service agreement with the taxpayer. Under the agreement, the taxpayer is required to perform various preventative and remedial maintenance procedures on the equipment. Required materials are provided on a no-charge basis. In addition, the taxpayer will furnish and install software updates as they are released by the taxpayer for equipment covered by a service agreement at no additional charge to the customer.

The taxpayer has been accruing use tax on the cost of materials furnished under the optional service agreements. At issue is the application of tax to the portions of the service agreement attributable to the software.

Regulation 1502(f)(1)(C) provides that an optional maintenance agreement that contemplates the providing of program updates on storage media is regarded as a contract for the sale of tangible personal property. Tax applies to the sale or use of such maintenance agreements inside this state. Under these facts, the service agreement is regarded as both an optional maintenance agreement of the equipment as well as an optional maintenance agreement for the software. As such, tax applies to the portion of the lump-sum service agreement that represents the charge for the optional software maintenance. The taxpayer should report and pay tax to the Board measured by the amount allocated to the software maintenance portion of the lump-sum charge for the service agreement. 5/29/96. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0365 Optional Software Maintenance Contract. Tax applies to charges for optional software maintenance contracts if it is contemplated that during the terms of the contracts customers will receive revised or updated versions of the prewritten programs on tangible storage media if there is a problem identified with the programs. The transfers of updates or revisions are not incidental to the provision of support services, even if the revisions or updates are rare. 3/23/88. (Am. 2003–2). (Am. 2004–2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0372 Out-of-State Use of Programs. A taxpayer has computer centers in California and in other states. It purchases prewritten programs. Royalties are paid to the vendors depending upon the total use made of the programs. In some cases, the purchased programs are copied and the copies are sent to the out-of-state centers. In other cases, the original tape is sent to the out-of-state centers by the taxpayer. Tax applies to the entire royalty charge because there was a completed taxable sale in California. It is immaterial that there is a use outside the state. 6/5/81.

120.0387 Pen Plotted Drawings. Pen plotted drawings are furnished based on drawings, blueprints, sketches, and written description furnished by customers. This transaction constitutes the mere reformatting of data or converting data from one form to another, and is taxable under the rationale set out in *Albers v. State Board of Equalization*, 237 Cal.App.2d 494. 12/20/88.

120.0400 Photographic Image. The transfer of a photograph through a remote electronic wire service is not a transfer of tangible personal property. Charges for such service is nontaxable.

“Remote” means that the transmission must occur from premises other than that of the receiver. 11/26/91.

120.0406 Processing Healthcare Claim Forms. A taxpayer, who is located out of state, is engaged in the business of processing healthcare claim forms for California customers. The taxpayer receives either an electronic or physical claim from its customers and converts or reformats the claim to the proper format for the ultimate payer of the claim. The taxpayer then transmits the converted or reformatted claim to the appropriate insurance company (payer) for processing and provides its customer with a copy of the claims it processed in a CD ROM format. The taxpayer charges its customers a “claims conversion fee” which includes “data analysis and reporting” and an “archival fee” for providing of a copy of the claim on CD ROM. The data analysis and reporting consist of summarizing or extracting information from customer-furnished claims forms for inclusion in a report wholly separate and apart from the CD ROM provided as part of the taxpayer’s archival fee.

When the taxpayer electronically transmits claims to the payer, the customer is charged a “one-way transmittal fee.” Also, a “clearinghouse fee” is charged to the customer for electronically transmitting claims from the customer to the taxpayer, repricing the claim and transmitting the claim to the payer. This fee includes data analysis and reporting. Under these facts, tax does not apply to taxpayer’s charges for claims conversion since that fee represents a charge for the processing of customer-furnished information. The “clearinghouse fee” is similar to the “claims conversion fee” in that the taxpayer summarizes or extracts information from customer-furnished claims for inclusion in a report wholly separate and apart from the CD ROM provided as part of the taxpayer’s archival fee. As such, tax also does not apply to the clearinghouse fee. Also, tax does not apply to “one-way transmittal fee” since this fee only relates to the electronic transmission of a claim from the taxpayer to the payer.

Tax does apply, however, to the taxpayer’s “archival fee” since it is only converting a claim from an electronic image to a CD ROM and then selling that CD ROM to its customers. Sales tax applies to this fee when the sale of the CD ROM takes place inside this state and there is some participation in the transaction by a location of taxpayer in California. When sales tax does not apply, use tax is imposed on the sales price of the CD ROM; the taxpayer must collect that amount from its customers and pay it to the Board. 06/24/96.

120.0410 Program Error Corrections. A taxpayer designs and sells software programs.

It also sells a lump-sum optional maintenance contract that offers customers telephone support, plus software updates and enhancements. The taxpayer discovers errors in a software program and issues error corrections on diskettes to all of its software purchasers including those who had not purchased a maintenance contract. On the basis that all software purchasers receive corrections, the taxpayer contends that the maintenance contracts are entirely for services not subject to tax.

Even though the taxpayer gratuitously provides error corrections to its customers who do not purchase maintenance contracts, the taxpayer’s maintenance contracts are not “solely consultation services.” The taxpayer charges the maintenance-contract customers a lump-sum amount for a maintenance contract that offers all updates, enhancements, and technical support. Also, the taxpayer transfers all program error corrections to all software purchasers by diskettes. When there is a taxable transfer of tangible personal property, the tax applies to the gross receipts including all services that are part of the sale, with only those deductions allowed by statute. Accordingly, the lump sum amount charged for the maintenance contracts is fully taxable, even though a portion of the charge is for consultation services. This is because the consultation services are a mandatory part of the maintenance contract under which the taxpayer sells tangible personal property since the customers do not have the opportunity to purchase the consulting services separately from the purchases of the updates or enhancements. 4/19/94. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0455 Reprogramming Activity Conducted on Customer's Computer. In reprogramming, updating, or error correcting, a taxpayer's employees take a floppy disk to the place of business of the customer, insert the disk in a disk drive, and copy the program into the memory of the customer's computer by operating the computer. The taxpayer's employees then remove the disk and return with the disk to the taxpayer's place of business.

The charges for reprogramming activity conducted in this manner are not subject to the sales tax. There is no title transfer transaction and there is no lease transaction. Also, the reprogramming of a programmable piece of equipment does not constitute fabrication or processing of the equipment. Rather, the charges made for reprogramming are charges for the performance of a service, not for sale of tangible personal property. 3/23/95.

120.0490 Sale of Object Code and Source Code. A firm transfers source code to original equipment manufacturers (OEM) together with the object code. The OEM has a limited license to incorporate the object code into bundled product which it sells. The OEM may not sell or license the object code as a stand alone. The OEM uses the source code to create and modify the object code in various versions of hardware and software environments and to provide support services for bundled products.

Generally, the charge for the object code is based on per unit or percentage of the sales price of the bundled product. The charge for the source code may be incorporated into the license fee of the object code or it may be a separate flat fee site license.

The transfer of the source code is incidental to the transfer of the object code and is necessary for the OEM to manufacture and distribute the bundled product. The charge for the source code is nontaxable. The fact that the charge may be separately stated does not affect this conclusion. 5/6/93.

120.0510 Sales of Computer Software and Hardware. In making sales of computer software and hardware systems, a company itemized its billings, separately listing charges for hardware, software, and sales tax reimbursement on the hardware charges only. The software was fabricated out of state and shipped to the purchaser directly from the out-of-state developer. The transactions consisted of the company: (1) soliciting the sale of the system, (2) billing the customer for the hardware, software, training, and sales tax reimbursement on the hardware; (3) receiving payment from the customer in full; (4) paying the developer for the software, and (5) receiving a commission on the software sale from the developer. The company claims it always acted as agent for the software developer and that the collection of payments from the customers does not affect its status as an agent for the out-of-state developer.

The fact that the company collected payments for the software does not conclusively show that the company was selling the software on its own behalf,

rather than as an agent of the developer. However, it does create an inference that the company was the seller of the software. Therefore, it is necessary for the company to rebut this inference. 11/6/92.

120.0514 Sale of Software and Maintenance Contracts. An out-of-state taxpayer provides data processing and consulting services to banks, mortgage companies and credit unions in the origination, secondary marketing and servicing of single family mortgage loans. The taxpayer also sells software (prewritten) licenses to clients who prefer to do their own processing. The client has the choice of receiving the programs on tapes or to have them transferred by remote telecommunication. In conjunction with the sale of software the clients have the option of receiving updates of the software and telephone support under a support agreement. The clients are sent a tape with the changes each month. The tape contains a program activity report that lists the modules that are being changed that particular month. The client also receives a memorandum (on paper) which highlights some of the changes for the month. Fees charged to the clients are combined (referred to as bundled billing) into one amount and billed monthly. Some of the old contracts allow the separate billing of enhancements and telephone support. The enhancement/telephone support billing is a totally separate fee from the license fee. The taxpayer is looking into transferring these monthly updates and memorandums by remote telecommunications to its clients.

The sale of prewritten computer programs furnished on storage media constitutes a sale of tangible personal property that is subject to sales or use tax. The measure of tax includes all amounts charged by the seller for the sale of the software, including all licenses and other end user fees. (Regulation 1502(f)(1)(B).)

The sale of a software maintenance contract (updates and error correction provided on storage media, such as tapes) is also a sale of tangible personal property, and it is therefore subject to sales or use tax. (Regulation 1502(f)(1)(C).) The charges for services such as telephone support are taxable as part of the sale of that maintenance agreement unless such services are optional and the customer may contract for those services for a separately stated price. (Regulation 1502(f)(1)(C).) The services are optional only if the customer may purchase the maintenance contract without purchasing the service.

Tax does not apply where the only transfers to the customer are by remote telecommunication from the seller's computer to the customer's computer and the customer does not obtain possession of any tangible personal property in the transaction. If the transfer of a prewritten program is a nontaxable transaction, then the seller is the consumer of tangible personal property used to produce written documentation or manuals that are transferred to the customer for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge. 11/3/95. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0518 Sale—Transfer via Modem. The transfer of illustrations to a client via modem for a fee licensing their use is neither a sale nor a lease as there has been no

transfer of tangible personal property. The fact that the illustrations could have been transferred on disc or on paper during the illustrator's routine visits to the client is irrelevant as neither alternative was taken. 3/11/94.

120.0520 Sales of Programs to Value Added Reseller. A computer software company transfers its programs to a Value Added Reseller (VAR). The VAR generally uses the company's programs to develop, market, and sublicense application programs which include, as a component part, the company's programs or a function of the company's program. Since the VAR does not sell the actual software received from the company nor does it physically incorporate the software into tangible personal property sold by the VAR, the transfer by the company is not a sale for resale. However, a license fee paid specifically for the right to reproduce or copy a program to which a federal copyright attaches is not taxable. (See Regulation 1502(f)(1)(B).) 7/20/93.

120.0522 Scanning. Since original information is not developed in the scanning process, scanning is regarded as the conversion of customer furnished data from one physical form of recordation to another. Charges for scanning are therefore subject to tax when the scanning results in the transfer of disk or other storage media. When the scanning is transmitted electronically and there is no transfer of tangible personal property, tax does not apply. 2/18/94. (Am. 99-2).

120.0524 Security Key Installed with Load and Leave Software. A taxpayer sells and physically installs software on the customer's computer at the customer's office, without leaving any software disks with the customer. The taxpayer also installs a "dongle" on the customer's computer. This is a piece of tangible personal property used as security key for the software. The software was designed to be effectively nonfunctional without the installation of the dongle. Therefore, when the customer purchases the software, the customer must also obtain an important piece of tangible personal property that the customer will use to make the software functional. Accordingly, the charge for the software license that involves the transfer of the dongle is taxable without regard to the manner of transfer of the software. 9/23/99. (2000-2).

120.0525 Settlement of Disputed License Fees. A customer acquired software products under a license which limited its use to a central processing unit. The vendor claims that the software was being used in an unauthorized manner. The customer disputed the claim, but ultimately paid \$250,000 in settlement of the claim. The \$250,000 is part of gross receipts subject to tax. The settlement fee was paid in order to settle the dispute over amounts owed attributable to the acquisition of the software and the accompanying license fees. Such payment for additional license fees are subject to tax. 3/17/97.

120.0528 "Site License" Fees. "Site license" fees, which permit purchasers of computer software to make additional copies, represent additional gross receipts from the original sale of the pre-written computer program. If a customer first purchases the program, and later purchases the site license, tax applies first to the program and at a later date to the site license fees. 1/27/86.

120.0531 Software and Software Updates Installed into Customer's Computer. When a person operates a customer's computer to transfer computer software

directly into the permanent storage memory of the customer's computer, and maintains complete and exclusive control over the customer's computer during the entire process, the transaction is not a sale of tangible personal property, provided the taxpayer does not provide the customer with a hard copy or any other tangible personal property. On the other hand, when the transferor downloads the software onto "some other type of computer storage device owned by the customer," such as diskette, tape or CD, the transferor would be performing fabrication labor on customer-furnished property. This fabrication is a "sale" under section 6006(b). The same analysis applies to optional software maintenance agreements where software updates are delivered as described above. 4/10/97.

120.0532 Software Installation Charge. A retailer transfers software to customers on tangible media pursuant to a basic software license agreement. The software is for the customer's own use. The license fee includes all charges for installation of this software, installation support services (includes training classes for customer's employees), and warranty. Out-of-pocket expense costs and expenses incurred by the retailer when providing pre-installation support services and installation support services or warranty work are separately billed to purchaser and include transportation expenses, motel accommodations, meals, telephone charges, and mailing expenses.

A charge for testing a prewritten program on the purchaser's computer to ensure that the program operates as required is the only charge regarded as an installation charge. (Regulation 1502(f)(1)(E).) Although there is no requirement to separately state such charges, the Board strongly recommends that it be separately stated. All the other services listed which the customer is required to purchase in order to purchase the software are services part of the sale, the charge for which is subject to tax regardless of whether they are separately stated. The separate charges for out-of-pocket expenses are subject to tax except for those related to nontaxable installation. The charges should be prorated based on the charges to respective services to which they relate. 4/26/91.

120.0535 Software Libraries. A taxpayer is in the business of developing, licensing, and manufacturing hardware and software products and technology for distributed communications and control which allow systems to operate on an interactive basis. The taxpayer has a set of software libraries for the programming language. Portions of the libraries are used by customers who create application programs to incorporate into their programs. The libraries are delivered on a set of disks which contain an inexecutable object code and do not function as an application program by themselves.

A software developer enters into a written license agreement with the company governing the developer's rights relative to the libraries and has no right to resell the libraries as received. A developer only has the right to resell an application program which has incorporated portions of the libraries.

The transfer of the libraries are nontaxable when the licensee acquires the software for incorporation into applications which are published and distributed

for a charge. Any storage media used to transmit the programs to the licensee are incidental to the nontaxable transfer.

When the company licenses a library to a licensee to create an application program for the licensee's own functional use, the charge is subject to tax.

A statement incorporated into or attached to the signed license between the company and the developer indicating that the library is being licensed for publication and distribution or whether it is being licensed for use would be evidence of the type or purpose of the transfer. However, if the licensee were to make a use of the program which renders the original transfer by the company subject to tax, the company would be liable for the payment of such tax. 9/11/92.

120.0538 Software License—Right to Use and Copy. "A" is the licensee of certain computer programs (Software Products) which it obtains from "B," an out-of-state author/licenser. The Software Products are copyrighted by B and various rights under the copyrights are transferred to A for which royalty payments are made. Copies of the Software Products are distributed for consideration in modified or unmodified form by A to third parties. A reports and remits to the Board sales tax computed on the gross receipts received for the copies of the Software Products.

The software agreement between A and B specifically grants A end user rights. Therefore, a portion of the fees paid by A are, in fact, attributable to end user fees. The supplements to the software agreement list designated CPUs and identify charges as "right-to-use fees" and "sub-licensing fees." The software agreement also states in part "solely for (A's) own internal business purposes." Thus, all amounts paid by A for the software agreement are subject to tax because the rights acquired are to use the software program and not to sell copies.

Parts of the sub-licensing agreement appear to come within the nontaxable area. The amounts paid for the right to make copies of the program for sale and for the right for demonstrating the sub-licensed program are not taxable. On the other hand, the amounts paid under the sub-licensing agreement for testing of CPU's and all other amounts paid for A's own use and are subject to sales or use tax. 3/16/88.

120.0539 Software—License to Use and Sell. Corporation A is a software manufacturer that purchased certain property from Corporation B which is also in the software developing and manufacturing business. The property purchased consisted of source code, duplication copies, consumer copies, and software documentation. The source code is maintained on a unique computer in another state, but the working copies are located in California.

The contract provided for Corporation B to retain royalties, which are contingent on future sales volumes by Corporation A, up to a stated amount. The source code is protected under federal copyrights. Corporation A purchased the source code to modify or expand it for purposes of copying and selling the modified program to others. Since the source code is protected under federal copyright, tax does not apply to Corporation B's sales of the source master code or to the transfer of tangible copy of the program transferred concurrently with the granting of the

right to copy the software for the purpose of selling it, and not for other use. Tax does not apply to the concurrent transfer of the tangible copy of the program because the transfer of that copy is considered to be incidental to the granting of the right to copy and sell the program.

In addition, Corporation B has transferred copies on storage media in addition to the single copy necessary to transmit the program for purposes of copying and selling. These copies are to be used for research and advanced development. Thus, Corporation A has also sold tangible personal property for use as a manufacturing aid. The sale of such additional tangible personal property is not incidental to the transfer of the source code. Corporation A also transferred software documentation, manuals, and other tangible personal property. Sales tax applies to the sale of that property if located inside California at the time of sale, and use tax applies to the use of property purchased by Corporation A outside California which is first functionally used inside this state, or which is brought into California within 90 days after purchase unless the property is stored outside this state on half or more of the time during the six-month period immediately following its entry into this state. 4/29/96.

120.0540 Software License Transfer Fee. A customer has been using software, purchased from the taxpayer, for several years. This customer paid sales tax reimbursement on the original software license when first purchased. The software is licensed to be used on only one computer system. The customer recently upgraded its computer hardware to new equipment. The taxpayer charged the customer a software license transfer fee to allow it to move the software to the new equipment.

The software license transfer fee charged to the customer to permit that customer to utilize the software on new computer equipment relates to the original sale of the software. Since the original sale was taxable, the additional fee is also taxable. 7/18/95.

120.0543 Software Maintenance Agreements—Delivered Electronically. A taxpayer, a software developer and publisher, sells software licenses and software maintenance agreements to its customer. Maintenance agreements are optional and are typically sold for a term of 12 months and renewed annually unless terminated by either party. Currently, the software licenses and updates provided in the software maintenance agreements are delivered in tangible form. The taxpayer will have the capacity to deliver software and updates electronically in the near future. As a result, future software licenses and maintenance agreements may not include a transfer of tangible personal property. Some customers have requested to terminate their existing maintenance agreements at the end of their 12-month term and sign new agreements detailing that the updates be transmitted electronically. The new maintenance agreements will be regarded as the transfer of non-tangible personal property where the taxpayer and its customers actually terminate their previous agreements and enter into new (and valid) agreements requiring the transmission of updates in electronic transmission, and the taxpayer actually transfers the updates in electronic transmission to its customers.

On occasion, customers will purchase additional software licenses throughout the year. In order to have all of the software maintenance agreements expire at the same time, the taxpayer's practice has been to terminate the existing maintenance agreement (granting credit for the unused portion) and have the customer sign new 12-month maintenance agreements for both the pre-existing and newly purchased license. All would then have the same term. The new agreements require electronic software transmission. The sale of the initial maintenance agreement was a taxable sale. A customer's return of only a portion of a maintenance agreement does not qualify as "returned merchandise" pursuant to Regulation 1655(a). There is no provision that allows the taxpayer to claim a tax credit (or deduction) based on the customer's return of an unused portion of the maintenance agreement.

In connection with its sales of software electronically, the taxpayer may send documentation in tangible form to its customers. This documentation may be sent either on paper or a CD-ROM. The CD-ROM does not contain any software such as a search engine in which to access particular information on the disk. Under these facts, the taxpayer's transfer of software documentation (and not the software itself) to its customers in either CD-ROM or paper form is subject to tax where it makes a separate charge to its customers for such documentation. Where no charge is made, the taxpayer is the consumer of its documentation materials. 4/19/96. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0544 **Software Maintenance Agreement—Updates Electronically Delivered.**

Taxpayer licenses software and software maintenance agreements to its customers. Maintenance agreements are optional and are usually sold in 12-month terms that renew annually unless terminated by either party. Currently, the software updates provided in the maintenance agreements are delivered in tangible form. New customers or renewals may request updates be delivered electronically.

The current agreement provides software updates be provided in tangible form and, thus, are subject to tax. If new customers or renewals contract for updates to be delivered in tangible form, tax applies to charges for the entire 12 months of those contracts. However, if new customers or renewals request the transmission of software updates solely by remote telecommunication, those new or renewal maintenance agreements will not be subject to tax provided the taxpayer delivers its software updates solely by remote telecommunications (e.g., via e-mail or internet transmission), and its customers do not receive any tangible personal property (such as storage media) as part of its update transaction. 5/29/97. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0550 Software Maintenance Contracts. Under a licensing agreement, a business provides software and maintenance of that software to a client. The maintenance is for providing updates and future releases of the software. The contract for providing updates and future releases is a contract for the sale of tangible personal property. The charges for such a software maintenance contract are subject to sales tax regardless that the maintenance contract may be optional with the purchaser.

The issue of optional v. mandatory charges on software maintenance contracts arises as to charges for telephone or on-site consultation services. If the purchaser may, at its option, contract for consultation services for a separately stated price, these optional charges are nontaxable. If the purchaser does not have the option to purchase the consultation services in addition to the storage media, the charges are taxable as services that are part of the sale of the storage media. 5/6/93. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0551 Software Licensing. A company develops and publishes video games that are currently manufactured and distributed on floppy disks. The company may issue nonexclusive licensing agreements for their product to persons who could be granted the right to convert and modify the video games to be compatible with computer/interactive entertainment formats. The company would supply to the licensees object code masters for the licensed games and mechanical art or film for all components necessary to complete the licensed products. The licensee pays the company (licensor) royalties equal to a percentage of net sales for the sale and distribution of the licensed products.

Royalties paid for the right to reproduce or copy a program to which a federal copyright attaches are not subject to tax provided the purpose is to publish and distribute the program to third parties for consideration.

Charges for transfers of mechanical art and film in connection with such licensing agreements are subject to tax.

Charges for transferring the data from floppy disc to CD ROM are subject to tax.

Rentals of video games to consumers are subject to tax pursuant to section 6006(g)(7) and section 6010(e)(7). 9/2/92.

120.0552 Software Licensing. A software products company markets a comprehensive mechanical computer aided engineering software system. The program, which is licensed, is an application program that permits a computer to perform specific tasks. The engineering technology is transferred to the end user on magnetic tape. The end user/customer signs one Master License Agreement. Additional software may be ordered by executing a supplemental Licensed Software Designation Agreement. The customer can obtain either an annual license or perpetual (an extended term) license.

When a customer obtains a perpetual license, they will frequently also obtain optional maintenance and support services. These services entitle the end user to receive services including:

- (1) updates and extensions on amendments of user documentation (manuals),
- (2) new versions of licensed programs which encompass improvements, extensions and other changes, and
- (3) corrections to user documentation and/or program codes. The transactions in question are:

(1) The customer obtains a perpetual license for two simultaneous users. Eight months later, the customer executes a new Agreement to expand to four simultaneous users. No additional tapes or manuals will be sent to the customer, but the customer is charged a fee for the addition of the two simultaneous users.

(2) The customer obtains a perpetual license for a drafting module. After three months, the customer adds the solid modeling module that is embodied on the same magnetic media as the drafting module. No additional tapes are sent to the customer. An additional manual is sent and a fee is charged for the additional module.

(3) The customer has obtained an annual license for a module and renews for an additional year. No additional tapes or manuals are sent to the customer, but an annual license fee is charged. The customer claims that additional charges are nontaxable because no additional tangible personal property was transferred.

The regulation provides that charges are nontaxable when the purchaser does not obtain possession of any tangible personal property. Under the facts provided, possession of tangible personal property was transferred and a charge was made for the customer's increased use of the property. The fees in each of the described situations are subject to tax. 1/6/92. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0560 Software Maintenance Policies. A retailer of laser printers and related prewritten or "canned" software also offers a maintenance policy for the software. The maintenance policy has two features, telephone consultation and updates or program enhancements. The updates are transferred on magnetic tape and are also "canned." The customers who purchase software are not required to purchase a maintenance policy but those that do must purchase the entire package, the telephone consultation and the updates. The charge is billed lump sum and no allocation is made between the telephone consultation and the updates. The company views the updates and program enhancements as incidental to the telephone consultation service.

Generally, telephone consultation is a service that does not by itself result in a tax liability. However, since the purchasers of the maintenance policies had to purchase the entire package, any person desiring the program updates had to pay for the telephone consultation as well. It follows that the telephone consultation was a "service that was part of the sale" of the program updates, and that the

entire charge to the customer for the software maintenance policy is subject to tax. 7/16/91. (Am. 2004–2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0560.225 Software Maintenance Services via Modem. A taxpayer's contract with its customers specifies that taxpayer would perform its software maintenance services, including transmission of program updates, by remote telecommunications means, i.e., by modem. In fact, the taxpayer would not contract with the customer unless the customer had a modem in order to receive software maintenance by telephone. Since the transfer of program updates is by remote telecommunications, there is no transfer of tangible personal property. Therefore, charges for this software maintenance service is not subject to tax. 3/23/95; 4/28/95.

120.0560.600 Software Rental and Installation Agreement. A taxpayer entered into a contract to license its software programs on a rental basis. It also rented computer hardware (on which it paid California sales tax reimbursement at the time of purchase) as well as a third party software license (on which it also paid sales tax reimbursement at time of purchase). In addition, the taxpayer's monthly charge to the client included a charge for installation and upgrade work.

The sale of the taxpayer's prewritten computer programs transferred to the customer in the form of storage media constitutes a sale of tangible personal property. Tax applies to the entire amount charged for the prewritten programs, including all license fees. (Regulation 1502 (f)(1).)

Labor charges for installation of prewritten programs are excluded from the measure of tax. Installation includes the actual installation of software and the testing of the prewritten programs on the purchaser's computer to ensure that the programs operate as required. (Regulation 1502(f)(1)(E).) This exclusion does not encompass any other services, such as converting a customer's data into a format suitable for use with the new software. Conversion services are part of the sale of the prewritten program and charges attributable to such services are taxable.

Since the taxpayer has timely paid "sales tax" on the hardware and the third party software and they are being leased in the same form as acquired (taxpayer transferred physical possession of the storage media on which the original third party software was acquired), tax does not apply to the amount charged by the taxpayer for the lease of these items. 1/18/96.

120.0560.750 Software Sublicensing Agreements. A software licensor (L) provides software to a computer equipment manufacturer (M) to be sublicensed to the end users of M's equipment. The agreement between L and M provides for a number of specified fees, some of which are taxable and some of which are not taxable.

Nontaxable fees include: An initial participation fee and an annual nonrefundable renewal fee, both of which are paid to L by M for the right to participate in the sublicensing program; commissions paid to M by L for each sublicense M issues to an end user; royalties paid by M to L for each sublicense issued; fees for

optional product support offered by L through M to M's sublicensees; fees paid by M to L for requested porting of program updates; and certification fees.

Taxable fees include: Charges to end users for the use of pre-existing programs, and technical support service fees which provide for updates paid by the end-user where the end-user has contracted directly with L or with M. 9/26/91.

120.0560.825 Software Support Agreement. A taxpayer sells software packages and software support agreements. Customers may choose one of the following support agreement options: full support or after-hours support. Full support includes telephone hotline support as well as software upgrades released during the maintenance period. The taxpayer charges one price for this full support. There is no segregation of price between the hotline and the upgrades. When an upgrade is released, the customers receive a software upgrade tape that they load onto their computer system. The taxpayer's employee then dials into the customer's system via modem and performs the procedures to actually install the new upgrade. The other option, after-hours support, basically consists of telephone hotline support. The customers who choose this option are not entitled to any software upgrades. A customer initially purchasing a software package is required to purchase one of the maintenance options for the first year. After the first year, the support agreement becomes optional. If a customer elects to discontinue the support, the customer cannot receive any future software upgrades unless all back support charges are paid.

Since the customers are required to purchase one of the maintenance alternatives for the first year, whichever support contract the customer selects is mandatory. Thus, the taxpayer's charges for all first-year support agreements are taxable. Even after the first year, all the taxpayer's charges for full support are taxable, even if that support is truly optional since the customer cannot purchase the software portion without also purchasing the services. The taxpayer may not deduct its charges for the services even if separately stated.

After the first year, when the maintenance contracts are optional, the taxpayer's charges for its after hours support are not taxable if they consist entirely of telephone support. When a customer who had discontinued support pays "back support charges" as a condition to obtaining a software upgrade, such charges are part of the sale of the upgrade and are subject to tax. 4/15/96. (Am. 2004-2).

(Note: Regulation 1502 was amended so that beginning January 1, 2003, 50 percent of the charge for optional software maintenance agreements is subject to tax. Prior to that date, generally 100 percent of the charge was subject to tax.)

120.0561 Software System—Access by Modem. A taxpayer is engaged in the business of providing computer services and software to school districts. It entered into a licensing agreement which included the following tasks:

- (1) Computer hardware review and planning session.
- (2) Software installation, training, users manual documentation delivery.
- (3) Final acceptance of software system.

The use of the software system will be made available to the school district through a telephone dial-up to the taxpayer's computer.

This is a nontaxable contract for service only and does not call for the transfer of tangible personal property. The school district's use of the program through a modem and the computer files prepared by the taxpayer also constitute nontaxable services. 7/31/87.

120.0562 Software Technical Assistance. Charges for software technical assistance given on a noncontractual, per-call basis are not taxable provided there is no tangible personal property transferred to the customer. 9/24/96.

120.0563 Source Code Transfers. A firm encodes its computer program on a master (ROM BIOS) chip, and transfers the chip together with the right to reproduce identical copies of the chip to its customer. For each chip copied the licensee pays a royalty.

In certain situations, the firm also furnishes human readable source code. The source code and other source materials allow the customer to modify the master chip's object code before reproducing the chip. The firm makes a one time flat fee for the license of the source code and restricts the licensee from selling, licensing, sublicensing, disclosing, or providing access to the source material.

The exclusion from tax contained in Regulation 1502(f)(1)(B) embraces both the source code version and the object code version. The licensee who receives the source code and other source materials acquires the information incidental to the licensing transaction. As long as the licensee acquires the right to reproduce and distribute copies of the program in object code format, and does not acquire a site license for the object code, it makes no difference that the licensee does not have a similar right with respect to the source code. 9/30/88.

120.0563.950 Special Employees v. Independent Contractors. In determining whether a taxpayer is making taxable sales under Regulation 1502(f)(2) or is merely furnishing "special employees" to its customers, the distinction between special employees and independent contractors must be drawn. Of the factors entering into this distinction, the primary one is whether the person for which the work is being done has the legal right to control the manner and means of accomplishing the results desired. Other factors to be considered are:

- (1) Whether the one performing the services is engaged in a distinct occupation or business,
- (2) Whether in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; the skill required in the particular occupation,
- (3) Whether the principal or the workman supplies the instruments, tools and place of work,
- (4) The length of time for which the services are to be performed,
- (5) The method of payment (time spent or by the job),
- (6) Whether the work is part of the regular business of the principal, and
- (7) Whether the parties believe they are creating the relationship of employer-employee. 11/22/77.

[120.0564](#) **“Special Employees”—Keystroking Services.** The performance of keystroking services to enter data from source documents to magnetic computer disks for a customer is taxable fabrication labor unless the services are performed by “special employees” on the customer’s premises. The distinction is whether the taxpayer is engaged to produce a finished product, or to provide personnel who will work under the direction and control of the customer.

In this instance, the taxpayer’s people were involved in handling the overflow of work normally done by the customer’s staff and the customer’s office manager assigned the tasks to be done. The supervisor provided by the taxpayer was only required when there were six or more temporary employees on a shift, and the contract specified that the work would be done “. . . as requested and directed by . . . (the customer).” Under these circumstances, the keystroking services were performed by “special employees” and the charges were not subject to tax. 12/19/79.

[120.0564.500](#) **Stock Quotations by Modem.** Charges for modem to modem stock quotations are not subject to tax where there is no transfer of any tangible personal property. 11/29/93.

[120.0565](#) **Subcontracting Custom Computer Program.** If a seller contracts with its customer to provide a custom computer program to the customer’s special order and then subcontracts with another person who creates the program to the special order of the seller’s customer, sales tax would not apply to the seller’s charge to the customer for the custom computer program. 8/23/93.

[120.0575](#) **Sublicense of Software.** A taxpayer obtains canned software from its lessor under a licensing agreement which that taxpayer will sublicense to its customer. The lease agreement requires a primary license charge plus annual license charges. Under the terms of the licensing agreement, if the annual license charge is not paid, the taxpayer must discontinue use of the product and return all copies to the lessor.

If the taxpayer transfers to its customer the actual software it obtains from the lessor and if the agreement requires that actual software be returned if the license fee is not paid, the transfer to the customer is a sublease under Regulation 1660(c)(5). The sublease is subject to use tax measured by the subrental payments unless the taxpayer makes a timely election to pay its lessor use tax measured by the rentals payable under the prime lease. (See Annotation 330.2170.)

If, however, the taxpayer were to retain the original media which it receives from the lessor and make a copy for lease to its customer, the taxpayer would be using the software obtained from the lessor and not leasing it. As a result, the transfer to the taxpayer of the original media would be a taxable retail sale under section 6006(g)(5) and the taxpayer’s transfer of the copy to its customer would also be taxable because the software transferred to the customer would not be the same media that the lessor acquired from the taxpayer. 6/22/95.

[120.0600](#) **Title Clause for Special Tooling.** A manufacturer and retailer of printed circuit boards incorporates a title clause in the quotations given to its customers stating that title to all tools and computer programs, purchased or manufactured

specifically for the contract which are used in the production or the testing of products, passes to the customer prior to the time the tools and computer programs are used by the seller.

Under these facts, the seller transfers title to the tools and computer programs to its customer prior to use in the manufacturing process. The seller may issue a resale certificate to its vendor to purchase the tools ex-tax. 8/23/93.

120.0650 Trade-in of Software. A retailer offers a promotional discount/trade-in whereby the customer was forced to give up his current software in order to obtain the company's so-called promotional discount. An agreed value between buyer and seller was reached as to the value of the traded in software.

When a retailer accepts a trade-in, the retailer must include in the measure of tax the amount agreed upon between the retailer and the buyer as the allowance for the merchandise traded in. If there is a trade-in and also a discount, the contract between the seller and the buyer must make it clear that the parties contract for both a trade-in allowance and for a discount. 12/14/92.

120.0655 Training Services—Sale of Software. If sales of computer programs include training services but the purchaser does not have the option to purchase the program without the services, then the consideration paid for the training is taxable as part of the sales of the computer software, whether such charge is separately stated or not. On the other hand, when the purchaser may, at its option, contract for the services for a separately stated price in addition to the charges made for the tangible personal property, then a reasonable charge for the services is nontaxable. 12/9/93.

120.0657 Training to Use Pre-Packaged Software—Optional. Charges for optional training is regarded as providing of a nontaxable service provided such training is not part of taxable consultation (see Regulation 1502(f)(1)(C)). 9/24/96.

120.0661 Transfer of Artwork by Artist via Computer. An artist prepares artwork and places it on the artist's removable computer storage media (e.g., floppy disk). The artist takes the disk to the customer's location, inserts the disk into the customer's computer, and transfers the artwork from the artist's disk to the customer's computer. The artist removes the disk and retains it, and does not otherwise provide any tangible personal property to the customer. The transfer is not a sale of tangible personal property provided the artist retains title to and possession of the disk at all times. For example, if, after inserting the disk and prior to its removal, the artist leaves the computer and the customer uses it, the artist would be regarded as making a taxable lease of the disk. 7/22/96.

120.0661.175 Transfer of Artwork—External Storage Diskettes. When an artist creates artwork on a client's computer and saves the artwork into the computer's memory, the artist's charge is nontaxable. In this situation, the artist does not transfer tangible personal property to the client. The same result is not reached when the artist transfers the artwork to external storage diskettes or disks and transfers them to the client, whether the client or the artist furnishes the removable disk or diskettes. When the artist furnishes the disk or diskettes, the artist is making a sale of tangible personal property under subdivision (a) of section 6006.

If the client furnishes either new or used disks or diskettes, the artist's charge for the work performed to create the artwork is a sale as defined in subdivision (b) of section 6006. The artist's charge for the sale, whether under subdivision (a) or (b) of section 6006, is subject to tax. 12/2/96.

120.0662 Transfer of Illustrations via Computer Modem. Tax does not apply to the transfer of illustrations by computer modem and when seller does not provide its customer with any tangible personal property. 04/18/96.

120.0663 Transfer of Images by Electronic Means. A taxpayer prepares advertisement layouts and transfers the image of the advertisement by modem to its client, or the taxpayer posts the advertisement on the Internet.

Sales tax does not apply to the taxpayer's charge because the taxpayer does not make a sale of tangible personal property when information is transferred by electronic means. On the other hand, if the taxpayer provides the client with a hard copy of the advertising layout or transfers the layout to the client on a computer diskette, the charge is subject to sales tax. 3/12/96.

120.0665 Transfer of Information from One Tape to Four Others. A firm is in the business of manufacturing and embossing credit cards for financial institutions. The information to be embossed is obtained from the financial institution on a data processing tape. Occasionally the firm's equipment cannot read the financial institution's tape because it is incompatible with the firm's equipment. In order to make it compatible with its equipment, the firm transfers the information on the tape to four tapes. In these cases, it makes a separate charge to the financial institution for "interim tape processing."

This charge is not a charge for processing customer furnished information as described in Regulation 1502 (d)(5). The contract with the financial institution is a contract to produce credit cards. The restructuring of the information is merely one step in the manufacturing process. The separately stated charge is part of the gross receipts from the manufacture of the credit cards. 5/13/93.

120.0667 Transfer of Program into Escrow. Corporation A sold all of its assets, including software, to Corporation B. The programs were transferred by network wire. The programs were designed to be used by banks and were written for the purpose of selling to banks and other financial institutions. For unknown reasons, the software was not marketed. The original master disks were retained by Corporation A, but were required under the contract to be stored in escrow. They were to be available to Corporation B for a period of five years to verify the accuracy of the wire transfer. Corporation A was barred from using, making copies of, or permitting other persons access to the disks. At the end of the five-year period, Corporation A was required to erase the disks.

The transaction is regarded as including the sale of the master disks since Corporation B obtained all of the rights of ownership except custody. The transfer of the disks was, however, not taxable because Corporation B purchased the software to obtain the right to reproduce or copy a program to which a federal copyright attaches in order to publish and distribute it for consideration to third parties. That is, subdivision 1502(f)(1)(B) is not limited to leases for copy and

sale, but also to transfers of title for such purposes. It is immaterial that Corporation B may have later decided not to market the program. 10/29/87; 2/18/92. (Am. M99-1).

120.0669 Transfer of Software Documentation. Taxpayer is in the business of developing and selling software. All sales of its product includes documentation. Customers will receive their documentation in one of three formats: paper copy, CD ROM, or via remote telecommunications. When the documentation is delivered either via CD ROM or electronically, it contains a search engine. The search engine enables a key word search of the documentation only and does not work on the software itself and is in no way an enabler of any of the actual software capabilities.

Regulation 1502(f)(1)(D) provides that the seller of a prewritten computer program transferred electronically is the consumer of property used to produce written documentation or manuals designated to facilitate the use of the program where the documentation or manuals are transferred with no additional charge. If a separate charge is made, then tax applies to the separate charges. Also, tax does not apply when the documentation or manual is transferred electronically to the customer since the customer will not receive any tangible personal property. The taxpayer is the consumer of the documentation and/or manual.

When a customer receives a CD ROM, it contains both documentation and a search engine. The search engine consists of prewritten software designed to provide access to the information contained on the CD ROM. Accordingly, the taxpayer is selling tangible personal property containing prewritten software in the form of a search engine. Its charge for that software is subject to the tax and is measured by either the taxpayer's separate charge for the search engine (provided it is not artificially low in order to avoid tax), or on the portion of the taxpayer's overall charge allocable to the sale of the prewritten software (i.e., the search engine) transferred in tangible form. 5/29/97.

120.0670 Transfer of Software Program. A software firm transferred the right to reproduce and copy a software application program to which a federal copyright attaches for a lump sum payment in order for the purchaser to publish and sell the program. Approximately ten days prior to the closing date of the purchase, the seller began transmitting the software program to the purchaser via electronic transmission to and through the purchaser's computer.

For technical reasons associated with the purchaser's plan to republish the software programs for sale to distributors and end-users, the purchaser would now like to take delivery of tangible media containing the software programs from the seller.

Under the facts provided, the seller's transfer of the program by electronic means was for the purpose of transferring the encoded data to the purchaser in order for the purchaser to copy and sell the program. Furthermore, the receipt of the program by remote telecommunications is not subject to sales or use tax. (Regulation 1502(f)(1)(D).) The seller's transfer of tangible media at a date later than the original transfer is for the purchaser to make a functional use of the media rather than to merely transfer the right to reproduce; the transfer of the right

to reproduce had already occurred. Therefore, if the purchaser makes a further payment to the seller, the transfer of the tangible media would be subject to tax measured by the seller's charge for the media.

However, if no further payment is required, tax would not apply to the seller's subsequent transfer of a tangible copy of the program together with the granting of the rights to reproduce or copy the program in order for the program to be published and distributed for a consideration to third parties. The transfer of the storage media would be regarded as incidental to the granting of the right to copy and sell the program. (Regulation 1502(f)(1)(B).) 2/17/95.

120.0760 Unlock Code Fee. A taxpayer sells CD-ROM disks which embody software programs. The purchaser of the disk has access only to certain programs on the disk, but may examine demonstrations of other software on the disk. The taxpayer has an "800" telephone number which the purchaser may call and pay a fee to obtain an unlock code for access to other programs on the disk.

The transfer of the disk is considered a sale of tangible personal property. The payment of a fee to obtain access to a portion of the disk is a further payment for use of the disk. Tax applies to the charge for the unlock code. 5/2/95.

120.0768 Update with Federal Copyright Attached. Even if an update is not custom software, when a federal copyright attaches to the update, its delivery is exempt from tax where its transfer to a customer is solely for republication to third parties by the customer as part of the customer's hardware under a license agreement. 1/21/88.

120.0800 Use of Purchased Software Program as Manufacturing Aid. Taxpayer creates custom computer programs which are written to the special order of the customer. On some customers' contracts, taxpayer will utilize a purchased software program as a tool to help produce the finished custom program.

Tax does not apply to a custom computer program. However, use of a purchased software program as a manufacturing aid to produce the custom program is a taxable use and tax applies to the purchase of the software by taxpayer.

Charges for additional copies of the custom program and charges for design and production of disc labels, disc sleeves and disc packaging are subject to tax. 11/13/91.

120.0840 Use of Software at a Central Location. A multistate corporation maintains a master computer center in California. The corporation routinely purchases prewritten software from vendors who ship the disk or tape to the California center. The software is installed into the master computer center. The corporation's locations from throughout the world then log onto the master computer center by remote telecommunication and download the software to their computers. The corporation pays an initial amount for the right to use the program at a stated number of locations. It also agrees to pay an additional fixed price for each additional location.

The programs are installed and used in California regardless of the location of persons who have access to the master computer. Tax applies to the initial amounts, the amounts paid for additional locations, and program updates if the

programs purchased are transmitted to the master computer center in tangible form.

Tax does not apply to contracts to transmit updates to the master computer center by remote telecommunication, provided that the updates are, in fact, transmitted by remote telecommunication with no transfer of tangible personal property. However, the application of tax to such contracts would not affect the application of tax to contracts, such as the initial purchase and previous update contracts, which provided for the transfer of tangible personal property such as storage media. 11/21/94.

120.0855 Use of Software—Transmittal by Remote Telecommunication. If a seller purchases a software program on disk for resale and transmits the contents of the disk to the customer by remote telecommunications, the seller has made a taxable use of the program and owes use tax measured by the cost of the program. 2/21/97.

120.0900 Word Processing Services. Gross receipts from a contract to provide word processing services, when the product is either on a diskette or hard copy, are nontaxable. The person who provides the word processing is the consumer of, and tax applies to the sale to that person, of tangible personal property which they transfer to their customers incidental to the service. If the contract requires only a diskette or a hard copy, the sale of another copy, either in diskette or hard copy form, is a sale of tangible personal property to which sales tax applies. If the product is a combination of composed type and illustrations, tax applies to the total charge attributable to those pages which contain illustrations. 8/23/93.

120.0905 Written Documentation in Connection with Software Transferred by Remote Telecommunications. Tax does not apply to the charge for the transfer of software via a network bulletin board irrespective of the later incidental transfer of written documentation. The later transfer of written documentation will not convert an otherwise nontaxable transaction into a taxable one. Since the function of the written documentation is simply to facilitate the use of the computer program, the transfer of the documentation is incidental to the true object of the transaction, which is to obtain the computer program itself. 3/29/85.

120.0925 Furnishing of a Computer System and of Images on a Disk. A taxpayer furnishes a computer system to a customer. The taxpayer also digitally stores images on disks in a camera and either furnishes the disks to the customer or installs the information from the disk onto the computer which is in the possession of the customer. The parties regard the arrangement as a service agreement.

Regardless of what the agreement is called, the transaction is a lease of the computer system and a sale of the disk. 11/3/94.

120.0930 Interactive Presentations. Interactive corporate training and sales presentations which are delivered to customers on computer disks or CD ROMs and run on automatic data processing equipment qualify as computer programs. If the interactive presentation is completely designed for a particular customer (custom program) rather than a modified prewritten program, the sale would not

be taxable. If an existing program is modified, sales or use tax applies to the charge for the presentation. However, tax does not apply to separately stated charge for modification made to the program for the customer. On the other hand, if a separate charge is not made for modifying an existing program, tax applies to the entire charge made to the customer unless the modification is so significant that the new program qualifies as a custom program based on the following criteria:

(1) If the prewritten program was previously marketed, the new program will qualify as a custom program if the price of the prewritten program is 50 percent or less of the price of the new program.

(2) If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for the custom modifications is more than 50 percent of the contract price to the customer. (Regulation 1502(f)(2)(B).) 6/20/95.

(b) PROCESSING CUSTOMER-FURNISHED INFORMATION

120.1115 Analysis Services in Connection with Sales of Software. A taxpayer sells a complete package of software which includes the software system, a user's guide, periodic updates of the software, and an analysis of monthly data submitted to the taxpayer by the customer.

The software and the updates are tangible personal property and subject to tax. While the analysis of monthly data is the "processing of customer's furnished information," it remains part of the sales price of the software. These "services" represent services that are part of the sale of the software which the customer cannot acquire without also obtaining the "services." 6/24/91.

120.1155 Birthday Notices—Restaurant. A firm receives registration forms from a restaurant. It enters the data on a disk and sends it to a data processing service bureau which maintains a file of the customers. Each month the service bureau prepares a tape of customers who have birthdays during the month. The tape is sent to a laser printing firm which prints the name and addresses on cards. In some cases a message is added. The charge by the printing firm is the same whether or not a message is added.

The laser printing operation results in a sale by the firm to its customer when the printer prints the names, addresses and a message. Any printing beyond the name and address subjects the entire charge to tax including charges for maintaining the customer's file.

On the other hand, if only the name and address is printed, the transaction is nontaxable as a mailing service. The addition of a salutation (Dear-----) would not make the addressing taxable. 3/1/84.

120.1160 Computerized Services. A taxpayer provides certain computerized services for automobile service stations. The client service stations are provided with work order forms, mailers, and certain other supplies. The clients send a copy of the work order on each lube job, etc., to the taxpayer weekly. The customer's name, address, car mileage, type of work, etc., is taken from the work orders and entered into a computer. The computer produces an immediate "thank you" card that is

sent directly to each client's customer. The clients receive a monthly customer listing printout, alphabetized and in zip code order, showing various data such as work order breakdown, employee production, etc. The taxpayer charges a one-time fee for computer set up, work orders, and supplies. Thereafter, there is a charge per card mailed, a charge per page for the customer listing printout, and a monthly charge for a management fee, plus shipping charges.

This taxpayer is processing customer furnished information when it inputs information from client work orders and produces a monthly report from this information showing customers listed in either alphabetic or zip code order, types of service, etc. It has been held previously that listing by zip code, for example, is regarded as more than "reformatting" as that term is used in Regulation 1502. Moreover, the information provided states that other tabulated information is available.

This taxpayer is the retailer of the cards it prints and sends to the client's customers and the charge made for printing the cards is also subject to tax. Since this taxpayer makes a single charge that includes the printing, postage, and mailing services, this taxpayer is entitled to make some segregation of the total charge per Regulation 1504(c)(2). 5/17/82. (Am. 2004-2).

120.1162 Conversion of Customer-Furnished Information. Company A, an out-of-state service bureau, processes client's computer tapes on its computer/microfiche processor to convert customer furnished information to microfilm. Company A claims to have no representative nor any operations in California. However, it does hold a Certificate of Registration—Use Tax for California. Tapes and microfilm are received and sent by mail.

The service provided is the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. Thus, Company A is regarded as selling microfilm and tapes to its customers. (Regulation 1502 (d)(1).) When the retail sales of these items are made to customers for delivery into California, the use tax applies. Since Company A holds a Certificate of Registration—Use tax, it is regarded as a retailer engaged in business in California and required to collect the use tax. 12/12/90.

120.1165 Copies of Reports. A taxpayer processes data for its customers and furnishes reports. The initial copy of each report is regarded as being furnished incidental to the service of processing and tax does not apply. The initial copy may be printed on paper, microfiche, or carbon copies produced simultaneously with the initial typing. Second and subsequent copies produced by printing are not regarded as being incidental to the performance of the service because they are not produced simultaneously with the original copy.

The taxpayer also furnishes its customers with real estate loan cards and perforated index cards. The real estate loan cards include the debtor's name and address, principal amount, interest rate, periodic payment amount, and other data calculated by processing customer-furnished information (e.g., delinquent amounts). The index cards are imprinted with summaries or extracts of information obtained from its files (e.g., interactive accounts). Tax does not apply to any item resulting from processing of customer furnished information.

However, tax does apply to any item which is essentially printed to the order of the customer and does not involve processing of the information, such as gummed labels containing computer generated unassigned account numbers. 6/26/87.

120.1170 Coupon Books. A taxpayer contracts to maintain records or accounts receivable for clients. Some clients desire that coupon books be prepared to show on each coupon the amount to be paid each month by the client's customers. The coupons are usually for a 12-month period. The amount may vary during the same 12-month period. The taxpayer produces the coupon books with electronic data processing equipment, places the books in envelopes and mails them to the client's customers. A separate charge is made for each book. The preparation of the coupon books is regarded as the same as preparing customer invoices. The taxpayer is providing a billing service for its clients. Tax does not apply to the charges for the coupon books. 7/22/77.

120.1174 Data Base Access. A taxpayer maintains a data base and sells computer access to its banks. The participating banks provide operating statistics. The taxpayer merges statistics from its client banks and provides tabulations on paper to them. The operation is not the exempt processing of customer data because the tabulations furnished to an individual bank are not limited to the data supplied by that bank. Tax applies to the charge for the printed tabulations. 9/7/82.

120.1175 Data Processing. Charges for the same data processing activities, e.g., data entry and verification, etc., may be taxable or nontaxable depending on the means of transferring the finished product to the customer. If the customer receives the data on storage media such as tape or disk or other media constituting tangible personal property, the charges are subject to tax. If the data is transferred electronically (modem to modem) to the customer's computer and no tangible personal property is transferred, there has been no sale and the tax does not apply. 4/29/94.

120.1176 Data Recovery Services. When a computer disk drive loses data due to software issues or physical damage to the drive like fire, water, etc., taxpayer performs various operations designed to retrieve the lost data for the customer. Taxpayer buys DVDs, CDs and refurbished disk drives on a tax-paid basis or tax is accrued at the time of purchase. The taxpayer's charge for this service is generally between \$500 and \$1,000 and the operations generally fall into five categories:

1. The customer's disk drive is sent to taxpayer who recovers the data and puts it back on the disk drive. The disk drive, along with the restored data, is returned to the customer.
2. The customer sends their damaged and unusable disk drive to the taxpayer. The data is recovered and posted on a website. The broken drive is returned to the customer along with a login code and password that allows the customer to download the data from the website.
3. The customer sends the disk drive to taxpayer who determines that the disk drive is damaged and unusable. The data is recovered and saved on DVD/CD, which is returned to the customer along with the broken drive.

4. The customer sends their damaged and unusable disk drive to the taxpayer. The data is recovered and saved on a refurbished disk drive, which is sent back to the customer. A lump-sum fee with no break out of the refurbished drive is charged to the customer.

5. Same as number 4, but the sales invoice is broken out between the charge for the data recovery service and the disk drive.

In general, data recovery services are not taxable and tangible personal property transferred pursuant to these services is incidental. If the service provider transfers tangible personal property to the customer that is not incidental to the performance of the service, the service provider is the retailer and sales tax applies to the sale of such property. On the other hand, Regulation 1501 provides that the transfer of incidental tangible personal property by the person performing the service is a nontaxable event. In such case, tax applies to the service provider's acquisition of the property used in performing the service.

The first and second scenarios above do not include the transfer of tangible personal property to the customer, other than the return of the customer's own disk drive. If the operations are remedial measures to correct a hardware problem, they are repair operations and regarded as a service.

Remedial measures to correct a software malfunction, such as a corrupted file allocation table that no longer records the location of the customer's data on the storage device, constitute the processing of customer-furnished information, the charge for which is not subject to tax. The creation of a new file allocation table that allows the customer to regain access to the lost data is considered to be summarizing and sorting the customer's existing data and sales tax will not apply to charges for this service, pursuant to Regulation 1502. In addition, since the customer only obtains the data by accessing it and downloading it from the website, there is no sale of tangible personal property, and no tax would apply to the charges for this service.

The remaining three scenarios involve the transfer of tangible personal property in the form of a storage medium that was not furnished by the customer and which contains the customer's restored data. Under the assumption that these scenarios arise from an unrepairable storage device or corrupted data, we regard the data as no longer existing in its original form, and any recovered data constitutes "original information" derived from data furnished by the customer. The true object of the contract is the performance of a data recovery service and the storage medium furnished to the customer is merely incidental to providing the service.

However, the last scenario provides for a separately stated charge for the refurbished disk drive that is transferred to the customer. In this case, the taxpayer is the retailer of the refurbished disk drive and this charge is subject to tax. If taxpayer purchases the disk drives on a tax-paid basis, a tax-paid purchases resold deduction may be taken and the taxpayer is required to hold a seller's permit for these types of transactions. 3/16/07. (2008-1).

120.1178 Demographic Report. A firm obtains market survey cards completed by its client's customers. It encodes the information and provides the client

demographic information about its customers. The information furnished to the client may be printed or on a floppy disk. The contract for these reports is for nontaxable service of processing customer furnished information. 3/30/89.

120.1180 Design of Image for Software. A taxpayer contracts to design an opening screen for a software product that its customer will market to the public. The taxpayer will give the customer the file electronically and the customer will program it to be interactive.

For another customer, an Internet service provider, the taxpayer contracts to design a “Home Page”. The customer will be provided with an electronic file for it to manipulate and make interactive.

When a taxpayer sells a design to a software retailer who will use the image as an opening screen for software it sells, the taxpayer’s sale is not a sale for resale. When a taxpayer sells a design to the software retailer, the software retailer does not sell that design to another person; rather, the retailer uses the design by recreating the image on its software. The taxpayer’s sale of the design to the retailer for that purpose is a taxable retail sale. Similarly, the taxpayer’s sale of a design to the Internet service provider to use as a home page is a retail sale subject to sales tax.

However, if the design is transferred to the customer electronically by fax or modem and the taxpayer does not transfer any tangible personal property such as storage media to the customer, such a transfer is considered to be an electronic transfer of information and not a sale of tangible personal property. Sales tax would not apply to the charge in such cases. 5/12/95.

120.1200 Digitized Photographs. A corporation takes color photographs of homes which are being offered for sale. It digitizes the photographs and provides them to a real estate multiple listing service which furnishes them to its members. If the corporation provides the digitized photographic images on disk, tape or other storage medium, the transfer is a retail sale subject to tax. If the transfer is by remote telecommunication, such as by modem, tax does not apply. 7/14/94.

120.1220 Digitizing Audio and Video Tapes. A taxpayer converts customer furnished information stored in analog format on tapes (e.g., VHS, Hi8) into digital format on computer disks. The taxpayer’s charge for the computer disks containing the digital files is taxable. 7/2/97. (M98–3).

120.1325 Fingerprinting—Construction of a Mathematical Model. The customer provides a fingerprint and the taxpayer translates it into a digitized image. During this step a mathematical model of “minutae” derived from the image of the fingerprint is created. This process is considered nontaxable development of original information from customer-furnished information under Regulation 1502(d)(5). “Minutae” refers to the location and interrelationship of those critical points within the fingerprint that allow fingerprint matching. 7/9/90.

120.1800 Letters to Mythical Characters. A company produces response letters to send to children who write to mythical characters. Each letter will be comprised of both a section of original text and a section of text which will be generated by assembling the appropriate paragraphs from a pre-existing paragraph library.

Some of the pre-existing paragraphs will be modified slightly to insert variable information to personalize them. The company's pre-existing data base will also include illustrations to be incorporated into each letter.

The company is not sending professional services nor is it transcribing services of someone else. The company's response letters are taxable as multiple copies. The letters do not qualify for exemption as processing of customer furnished information. 5/9/91.

120.2000 Magnetic Storage Media Transferred. When a word processing service records a customer's manuscript on customer-supplied data processing media or taxpayer-supplied data processing media, tax applies to the charge when the data processing media is transferred to the customer. If the word processing service also transfers a reading copy (printed copy) of the manuscript along with the media and the customer is charged a lump-sum price, tax applies to 50% of the amount charged which represents the charge for the media.

The encoding of the manuscript on data processing media is similar in concept to the keyboarding services involved in the case of *Intellidata, Inc. v. State Board of Equalization*, 139 Cal.App.3d 594. While the typing of a manuscript is a service, the furnishing of the encoded media is the sale of tangible personal property. Since an equal amount of effort had gone into the two objects of the contract, a 50% apportionment is appropriate. 8/26/86.

120.2620 Maintenance of Library Data Base. A contract calls for a data processor to continuously maintain and update a data base owned by a library. In addition the contract also requires the processor to expand the data base to encompass the conversion of records to a new national standard library format. Under these circumstances the data processor is providing a nontaxable service for the processing of customer furnished information. (Regulation 1502 (d)(5).) 11/29/89.

120.2635 Microfiche Copies. A data processing service bureau provides processing services in microfiche form. The customers furnish information on various transactions which is processed to produce a magnetic tape. The tape is further processed to develop a negative which is called the "master copy." The company then makes one or more microfiche copies from the master copy. The master negative is retained by the company from one to six months, after which time the customer has the option to receive it at no extra charge or it is disposed of by the company.

With regard to the data processing service charge, tax does not apply to the charges made for the data processing as well as the production of both the master negative and the first microfiche copy which is made from the master negative and transferred to the customer. These charges are for the rendition of the nontaxable service. The charge for any additional copies of the microfiche furnished to the customer is subject to tax. 5/18/84.

120.2779 Processing Customer-Furnished Information. A taxpayer receives documents from a client which are inputted into the computer using a scanner. The taxpayer then extracts, manipulates, and sorts the data from the documents according to the contracted instructions of its client. The data is then written onto

an output medium, CDs (compact disks). The taxpayer makes a separate charge to its customer for the cost of the compact disks used to transfer the original information developed by the taxpayer. The taxpayer also makes a separate charge to its customer for pick-up and delivery of the customer-furnished documents and the compact disk containing the original information developed by the taxpayer.

The extracting, manipulating, and sorting data furnished by the taxpayer's customers, and the updating of a continuous file of information maintained by the customer, constitute a nontaxable processing service under Regulation 1502(d)(5). Accordingly, the charges for this service are not subject to sales tax. The separately-stated charges for the cost of the compact disks used to transfer the original information developed by the taxpayer are subject to the sales tax. Regulation 1502(h) specifically provides that if the data processing firm's billing is for nontaxable processing of customer-furnished information, tax will not apply to pick-up and delivery charges. Thus, the pick-up and delivery charges for the customer-furnished documents and the compact disks containing the original information developed by the taxpayer are not subject to tax. 10/31/96.

120.2780 Processing Customer-Furnished Information. A taxpayer is in the business of automating legal documents for customers, making them easily searchable by computer, using a key word or phrase. The documents are first scanned into a computer and temporarily stored on a disk. The scanned images on the disk are then placed into a laser data format, and the printed words changed into an ASCII text file. A high speed computer software then indexes each word into a database and cross references it back to the original document.

If all the taxpayer did was convert the customers data from paper documents to computer storage, the charge for the conversions would be subject to tax. However, creating an index is considered a sorting and sequencing function, which are examples of nontaxable processing of customer-furnished information. Regulation 1502 (d)(5)(E) does not require an allocation between operations, which if performed by themselves would be taxable from those that are nontaxable; rather, as long as customer furnished information is processed, the entire transaction relating to the copying and processing of the original information is nontaxable. However, additional copies of records, reports, tabulations, and storage media are taxable. 1/29/93.

120.2783 Processing Customer Information. Customers provide their diaries or logs for processing by the taxpayer for a fee. The taxpayer returns the results in hard copy to each customer in a cost or expense summarization type format.

The taxpayer is providing a service and the transfer of the hard copy of the processed information is only incidental to the provision of the service. Thus, the charges for these services are excluded from the measure of tax. The taxpayer is the consumer of all tangible personal property which is used in providing these nontaxable services. 12/9/93.

120.2788 Processor of Credit Card Transactions. A processor of credit card transactions contracts with banks and airlines to process their credit card transactions. The processor receives charge account sales documents or tapes

reflecting the transactions and enters the information from those documents in its computer system. The resulting charge account statements are mailed out. The processor's charges and their tax applications are set forth below.

(1) The credit card company (e.g., Visa, MasterCard) distributes lists (hard copy) of bad card numbers to merchants. The credit card company bills the credit card processor who in turn bills its customers with a mark-up.

Charges for these lists of bad card numbers are either taxable as sales of additional copies of records or tabulations pursuant to Regulation 1502(d)(5)(F) or taxable as printed matter under Regulation 1541(a), depending upon further facts.

(2) A charge is made to the credit card processor's customers for a mailer sent to credit card holders notifying them that their credit cards have been mailed.

Charges for notices sent to cardholders are for sales of printed matter and are taxable. Charges for services rendered in preparing material for mailing are, however, nontaxable pursuant to Regulation 1504(c). The charge for the printed matter should be separately stated from the charges for mailing services. 5/22/84.

120.2810 Seismic Data Acquisition and Processing. When the acquisition of seismic data is accomplished by a service company's field crew and includes the extensive involvement of licensed professional engineers exercising their professional judgment in making a wide variety of decisions to assure the most accurate information possible is obtained and the product of these efforts is delivered to the customer in written report form, the true object of the contract is the engineering services and the charges are not subject to tax.

The raw data may be referred by the customer to a processing company for refinement. This procedure involves many discretionary tests and decisions to remove extraneous "noises" and to make the data more accurate and usable. The true object of this contract is the development, through computer manipulation, of original data from raw data furnished by the customer. This constitutes "processing of customer-furnished information," which is nontaxable under Regulation 1502, as is any tangible personal property incidentally transferred therewith.

A single contract for acquisition and processing is also not taxable. 4/16/86.

120.2828 True Object of Contract. In addition to converting a customer's typed documents to computer readable form by means of optical character recognition equipment, a taxpayer also performs certain "processing of customer-furnished information" services such as deleting head notes, footnotes, or handwritten notes, and the resequencing of pages provided by the customer. Although these latter services are in the nature of processing of customer furnished data, they are of minimum significance in relation to the end product of computer readable media. The true object of the contract is the conversion of the data from one medium to another, which is a taxable event pursuant to Regulation 1502. 5/30/91.

120.2850 Updating Medical Files. A computer service firm receives from a customer's nursing facilities the handwritten patient records reflecting physician's orders,

plan of care, etc., for the subject patient. The firm enters the information into its computer, creates a file on the patient, and prints out the various patient chart forms requested by the customer. As changes in the physician's orders, plan of care, etc., are made, the facility transmits the information in writing to the firm. The firm enters the new data into the computer and merges it with the patient's file. The firm prints the new forms with the revised patient information and sends them to the customer.

The activities described qualify as processing of customer furnished information because a file of information is maintained on the patient which is periodically updated to reflect reported changes. (Regulation 1502(d)(5).) Therefore, the medical data processing activities qualify as services not subject to tax. 6/30/82.

(c) CUSTOM PROGRAMS

[120.3044](#) **Basic Operational Program—Custom Computer Program.** A “basic operational program” as defined in section 995.2 of the Revenue and Taxation Code means, among other things, a computer program which is fundamentally necessary to the functions of a computer, and is specifically excluded from the definition of a custom computer program. By contrast, application programs are not basic operational programs. Under section 995.2, MS-DOS, OS/2, and UNIX are basic operational programs. APPLETALE may or may not be a basic operational program, depending upon whether it is an integral part of Apple Computer's operating software. Whether any particular utility program is or is not a basic operational program would depend upon whether it meets the section 995.2 definition. These definitions of basic operational programs are used in determining whether a computer program is a “basic operational program” as that term is used in Regulation 1502.

If custom modifications to a basic operational program are developed, sales or use tax applies to the charges if the modifications are transferred on storage media to the customer. If an entirely new custom computer program is developed which is a basic operational program, sales or use taxes will apply to the charges if tangible storage media is transferred to the customer. 9/18/89.

[120.3045](#) **Computer Programming Activities.** A company engaged in developing and selling computer programs entered into an agreement with a number of local government entities to perform certain computer programming activities related to the maintenance of a computerized data system. The computer program was originally developed by one entity and was eventually adopted for use by 14 entities. The issue is whether the company sold or fabricated custom computer programs for a single entity or whether the company prepared prewritten computer programs for repeated sales to various entities.

The entities involved joined together to execute a single contract with the company. All instructions were issued by a Joint Committee representing all of the entities and which acted as the executive body for the group. The evidence supports a finding that the entities formed a joint venture for the purpose of contracting with the company for computer programs. The company was, therefore, providing computer programs to the special order of a customer, the joint venture, and did not prepare computer programs for repeated sales or lease to

the individual entities. Under section 6010.9, the company's programs were custom programs the sales or leases of which are not subject to tax. It is immaterial that payment to the company was made by individual members of the joint venture. The payments were allocated and made in accordance with the contract which set up the joint venture. 7/6/83.

120.3050 Computer Programs Used to Operate Grading, Sizing, and Marker Making Machines. Grading and sizing involve adjusting the size to scale for different size garments for each of the components of the prototype garment. Marker making is determining the most efficient way for a manufacturer to cut raw cloth to minimize losses to scrap.

Persons who create the programs that operate these machines perform their design work using computer software. The finished product is downloaded on diskettes and then transferred to the customers for use in operating their machines. Persons who create and transfer designs on diskettes which are used to operate grading, sizing, and marker making machines are performing custom computer programming if the designs are prepared to the special order of the customer. Accordingly, the transfer of custom design on diskettes which are used to operate such machines constitutes nontaxable sales of custom computer programs. 6/23/97.

120.3055 Computer Program Translation Services. The translation of customers' computer application program codes to make the programs useable on a different brand of equipment is custom computer programming excluded from "sale" and "purchase" tax as it meets the criteria of modification to an existing program pursuant to section 6010.9(d). However, the translation of file records or data does not qualify for exclusion from that definition as they are not programs as defined in section 6010.9. They are also not exempt services as the true object of the contract is the property produced by the translation service and not the service per se. Charges for this service are subject to sales tax. 9/25/85.

120.3080 Custom Computer Programs. The determination of whether a computer program is a custom computer program must be made on a program by- program basis. When the taxpayer transfers a group of programs, some of which have been modified, he/she bears the responsibility to demonstrate which programs have been modified, in order to determine whether the modifications are of sufficient magnitude to qualify each modified program as a "custom program" per Regulation 1502 (f)(2)(B). 8/23/93.

120.3084 Custom Computer Software. A taxpayer sells computer software in connection with its sale of computerized branch exchange (CBX) systems. Each CBX is configured to meet the customer's unique requirements. Information on the number of lines, the actual extension number, and the type of devices on each line (console, terminal, plain phone, feature phone, etc.,) must be embedded in the CBX software. The public phone network system trunk, carrier (AT&T, MCI, Sprint), WATS, FX, or TIE lines which are to be connected to the CBX must also be programmed. Further, the CBX has a myriad of optional features which require software applications.

Assuming none of the software is a “basic operational program,” if the taxpayer substantially modifies prewritten software consisting of the “skeletal” make-up for all CBX systems in order to provide its customer with a unique CBX system, sales or use tax does not apply to charges for modifying this software when these charges are separately stated on the sales invoice to the customer. When the charges for customizing the software are not separately stated, tax does not apply to sales of the modified software only if the charge for customizing the software is more than 50 percent of the contract price for the CBX software. (Regulation 1502(f)(2).) 8/7/95.

120.3086 Custom Program Lease Receipts. A company designs and leases computer software for the pension service industry and provides consulting services for that industry. Since the company’s prewritten systems must be modified to conform with the customer’s particular hardware and unique application needs, each California customer who purchases a license to use the system pays a license fee that is comprised of two separately stated amounts: a charge of \$450 for the basic prewritten system, and a charge of \$475 for custom modifications to that system. The decision to charge on a flat rate basis was so that all customers would be aware and would be able to plan for their cost of the service. The company stated that because there is a flat rate charge for custom programming, there is a point beyond which customization is not provided. Therefore, it is common to have separate charges for data conversion.

The agreed price, as opposed to market value or some subsequently revealed price, dictates the appropriate sales and use tax treatment. Thus, the price charged for the basic prewritten system is the measure of the gross receipts. Regulation 1502 provides for an evaluation of whether or not there is a substantial modification only in the case of a charge for a custom program that is not separately stated. The charge in this case is separately stated. The law does not require that a business charge for its product in any specific fashion. It is reasonable that if the company is working under a flat fee concept, there must be a limit to the service it provides. The provision in the contract that protects the company from having to provide customization that was outside the scope of the norm amounts to a “safety valve” for the company to use in the event the customer desires service that goes beyond the scope of that which is presumed by the parties. Given these facts, there is no requirement for the company to charge on an hourly basis and the company has complied with the letter and intent of the law. Tax is due only on the flat fee charged for prewritten program. 5/25/91.

120.3088 Custom Programming Included in Sale of Computer. Where custom programming is furnished with computer equipment under a lump-sum contract, a reasonable allowance for the nontaxable custom programming must be made. The legislative finding that accompanied the enactment of section 6010.9 stated that sales of custom computer programs are service transactions not subject to tax and that the media used is only incidental to the true object of the transaction. The allowance mentioned above should not be given if the programming consists of modifications to a canned program. In such cases, section 6010.9(d) requires a separate charge for the modifications made. 11/13/84.

120.3090 Custom Programs. A specially developed version of a prewritten computer program made to function for the first time on a computer's basic operational system is a custom program if the prewritten program version will not function on that operational system. This is the case even though the prewritten versions may have varying degrees of source and object code similarity with the developed version. The reservations by the developer in the license agreement (pursuant to which the specially developed software is transferred) of the right to relicense and deliver that developed version to another customer will not affect it being a custom program.

The delivery of any modifications, enhancements, or upgrades to the specially developed version of the program for a first-time transferee will qualify as modifications of a custom program or a custom program if the prewritten modifications, enhancements, or upgrades will not function on the first-time transferee's computer system. 1/21/88.

120.3100 Customized Computer Programs. A company claimed that the software it sold qualified as customized computer programs, because they contained information unique to each customer. The unique information included the tax rate in the buyer's state, passwords, telephone numbers, provider numbers, hospitals, specialties, social security numbers, federal identification numbers, insurance forms utilized, office locations, and fee schedules.

The work of adding customer names or file headings to an existing computer program does not make the program a custom program. No separate charge was made for customizing the program, nor was there any evidence that the cost of the customization was more than 50 percent of the total contract price (See Regulation 1502 (f)(2)). The determination that the program sold by the company was prewritten, was further bolstered by the fact that more than one-half of the programs they sold, were sold for the same price. The price charged was too low to provide for the effort of creating a new custom program and the set price was indicative of a prewritten program rather than a custom program. 11/6/92.

120.3115 Customizing Programs. The encoding of the name and address of the purchaser and the utilization of this information throughout the program for purposes of display or printing on forms, statements, reports etc., is not the creation of a custom program. The sale of a basic program is subject to tax. Separately stated charges for tailoring the program with the purchaser's name and address are nontaxable as custom modifications. 3/14/83.

120.3175 Developing Software Program. A and B enter into a contract whereby A will assist B in developing computerized systems and data bases generally known as an Expert System (system that uses artificial intelligence techniques). Both parties are to provide their expertise and knowledge in their particular field to the venture. All ideas, inventions, hardware, firmware, software or documentation, whether or not protectable by copyright, patents or trade secrets, developed in the performance of the services will be jointly owned.

Under this scenario, the agreement is one for services only and not for services which are a part of the sale or lease of tangible personal property. Of course, if any tangible personal property is transferred by A to B in connection with the

performance of this contract, tax would apply to those charges. For example, the contract calls for third party products to be transferred without mark up.

Under a provision of the contract, A will transfer to B a copy of any knowledge base developed. This transfer would take the form of tangible personal property, such as tape, disk, or other magnetic storage media. Such a transfer of storage media would be merely incidental to the performance by A of the service of developing the knowledge base and not a sale of tangible personal property.

It is also possible that an “Expert System” developed by A and transferred to B might be considered a computer program as that term is defined in section 6010.9(c). If it is a computer program, rather than data or information, it would nevertheless be a nontaxable custom computer program under section 6010.9, since it would be prepared by A to the special order of B pursuant to the agreement. Thus, A would be considered to be providing the service of developing the custom program, rather than selling the program. 7/21/88.

120.3190 Diskettes Used to Operate Embroidery Machines. Regulation 1502 provides that tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Persons who create designs and transfer the design in machine-readable form to operate embroidery machines are performing custom computer programming services if the designs are prepared to the special order of the customer. In other words, the preparation of punched paper tapes and diskettes used to control the operations of embroidery machines for such purposes constitutes nontaxable custom computer programming under section 6010.9. 3/25/97.

120.3380 Multimedia Presentations. A company designs and produces custom interactive computer-based presentations. The customers take possession and title to the products on various storage media such as floppy or compact disks, hard drives, etc. The product combines still artwork with video, animation, narration, and graphics to create a unique interactive computer presentation.

Based on the understanding that the true object of the contract is to produce interactive presentations and that the item sold is a “program” as defined in Regulation 1502(f)(2), the property sold is a computer program notwithstanding the artwork embodied therein. The programs did not exist at the time of the contracts and they were produced to the special order of the customers.

If a portion of one or more prewritten programs are incorporated into the completed programs and if the charge for the modifications are separately stated from the charge for prewritten portions, the charge for modifications is nontaxable while the charge for the prewritten portion is taxable. Otherwise, the entire charge is taxable unless the modification is so significant that the new program qualifies as a “custom” program. Tax also applies to any duplicate copies of the custom software. 9/11/92.

120.3550 Programmable Calculator. A programmable calculator falls within the scope of the term “computer.” Thus, a custom computer program other than a basic operational program will not be subject to tax even though it is designed for use

by a programmable calculator. Further, this exclusion would extend to such custom programs when they are transferred in the form of magnetic cards or PROM (i.e., programmable read only memory). 12/24/82.

120.3645 Separate Charge. If a charge is made for a canned program and there is a separately stated charge for the modification of the canned program, only the charge for the modification is excluded from the measure of tax notwithstanding the fact that the modification represents more than 50% of the total charges. 1/31/95.

120.3670 Service Versus Sale. Custom computer programs are exempted by section 6010.9 as services even when included in the sale of computer equipment without a separate itemization of the charge. A reasonable allowance for the value of such services must be recognized in determining the measure of tax of such transactions. If, however, the programs included in the sale of the equipment consist of prewritten programs modified for the needs of the customer, section 6010.9 requires that the charges for the modifications be separately stated to be exempt from tax. 11/13/84.

120.3700 Software for Computerized Branch Exchange. A taxpayer's major product is a Computerized Branch Exchange system (CBX). Each CBX is configured to meet the customer's unique requirements. Therefore, the software of each CBX installation is unique. The taxpayer inputs information received from its customers with respect to the customers' needs into a separate program for use in generating the software necessary to run customer's individualized CBX system. The process requires the taxpayer to modify prewritten software consisting of the general framework for all CBX systems.

Under the scenario, tax does not apply to the taxpayer's charges for modifying this software when these charges are separately stated on the sales invoice to its customers. If the taxpayer does not separately state these charges and does not market or sell the prewritten component of software, the individual CBX software is "custom" and not subject to tax only if the charge for customizing the software was more than 50 percent of the contract price for the CBX software. When these conditions are met, the taxpayer's sale of the individualized CBX software is not subject to tax regardless of the form in which the program is transferred (i.e., via disk, tape, or modem), whether or not the software is sold in connection with the sale or lease of computer equipment and whether or not the charges for the software are separately stated. If these conditions are not met, tax applies to the entire charge for the software. 5/8/95.

120.3920 Test Programs. Computer programs developed to functionally test semiconductors on testing machines constitute custom computer programs, charges for which are not subject to tax. They do not constitute programs for operating programmable manufacturing machinery or equipment because the testing machine cannot be used to make, form, fabricate, process, or assemble a product or a component or ingredient of a product. 11/10/87.